

Legislative Audit Division

State of Montana



Report to the Legislature

December 2003

Financial Audit

For the Fiscal Year Ended June 30, 2003

Montana State University

A Component Unit of the State of Montana

We performed a financial audit of Montana State University's consolidated financial statements for the fiscal year ended June 30, 2003. The financial statements present the financial position, the results of operations, and the cash flows, on a consolidated basis, of all four campuses affiliated with Montana State University: Montana State University-Bozeman; Montana State University-Billings; Montana State University-Northern (located in Havre); and Montana State University College of Technology-Great Falls. The statements include comparative information for the fiscal year ended June 30, 2002. This report contains an unqualified opinion on the financial statements and accompanying notes for the fiscal year ended June 30, 2003 and the comparative information for the fiscal year ended June 30, 2002. The opinion means the reader may rely on the financial statement information presented.

This audit is performed to attest to the fairness of the consolidated financial statements of Montana State University. Audit issues, if any, identified during this audit have been discussed with university management.

Direct comments/inquiries to:
Legislative Audit Division
Room 160, State Capitol
PO Box 201705
Helena MT 59620-1705

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FINANCIAL AUDITS

Financial audits are conducted by the Legislative Audit Division to determine if the financial statements included in this report are presented fairly and the agency has complied with laws and regulations having a direct and material effect on the financial statements. In performing the audit work, the audit staff uses standards set forth by the American Institute of Certified Public Accountants and the United States General Accounting Office. Financial audit staff members hold degrees with an emphasis in accounting. Most staff members hold Certified Public Accountant (CPA) certificates.

Government Auditing Standards, the Single Audit Act Amendments of 1996 and OMB Circular A-133 require the auditor to issue certain financial, internal control, and compliance reports. This individual agency audit report is not intended to comply with these requirements and is therefore not intended for distribution to federal grantor agencies. The Legislative Audit Division issues a statewide biennial Single Audit Report which complies with the above reporting requirements. The Single Audit Report for the two fiscal years ended June 30, 2003, will be issued by March 31, 2004. The Single Audit Report for the two fiscal years ended June 30, 2001, was issued on March 26, 2002. Copies of the Single Audit Report can be obtained by contacting:

Single Audit Coordinator
Office of Budget and Program Planning
State Capitol
Helena MT 59620
Phone (406) 444-3616

Legislative Audit Division
Room 160, State Capitol
PO Box 201705
Helena MT 59620-1705

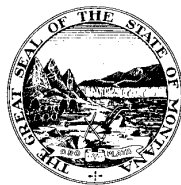
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Jim Pellegrini, Performance Audit
Tori Hunthausen, IS Audit & Operations
James Gillett, Financial-Compliance Audit

December 2003

The Legislative Audit Committee
of the Montana State Legislature:

This is our financial audit report on Montana State University's (university) consolidated financial statements for the fiscal year ended June 30, 2003. The statements include comparative information for the fiscal year ended June 30, 2002. The university requested this audit to provide timely audited financial statements to interested parties. The objective of our audit was to determine if the university's financial statements present fairly its financial position, the results of its operation, and its cash flows as of, and for the fiscal year ended, June 30, 2003. This objective included determining the university's compliance with laws and regulations having a direct and material impact on the financial statements. Our opinion for fiscal year 2002 is based on the audit we performed in the fall of 2002.

The university's financial statements report assets of approximately \$374.6 million, liabilities of approximately \$169.7 million, operating revenues exceeding \$242 million, and operating expenses of nearly \$324 million, for fiscal year 2003. Net non-operating revenues and expenses, gains and capital contributions were slightly over \$88 million for fiscal year 2003. Of this amount, state appropriations accounted for approximately \$77.6 million. Cash flows for fiscal year 2003 consisted of the following: \$56.2 million used in operations; \$92.1 million provided by non-capital financing; \$24.6 million used in capital financing; and \$3.4 million used in investing activities for fiscal year 2003. The term "used in" refers to net cash outflows, while "provided by" refers to net cash inflows.

The Board of Regents of Higher Education approved the current Montana University System structure in January 1994. Montana State University consists of campuses located in Bozeman, Billings, Havre, and Great Falls. All campuses are accredited by the Commission on Colleges of the Northwest Association of Schools and Colleges. The Montana State University campuses provide a diversity of undergraduate and graduate academic and two-year vocational/technical programs to students.

Montana State University-Bozeman was founded in February 1893 as the Agricultural College of the State of Montana. It is a land-grant institution, authorized by the Morrill Act of 1862, and receives part of its support from land-grant income. The campus offers four-year undergraduate programs along with master's and doctoral graduate programs. It includes the Colleges of Agriculture, Arts and Architecture, Business, Education, Health and Human Development, Engineering, Letters and Science, Nursing, and Graduate Studies.

The Bozeman campus also includes the Extension Service, the Agricultural Experiment Station, and the Fire Services Training School, which have facilities located in or near cities or towns throughout Montana.

Montana State University-Billings, established in 1927, consists of five colleges: the College of Arts and Sciences; the College of Business; the College of Education and Human Services; the College of Technology; and the College of Professional Studies and Lifelong Learning. MSU-Billings offers a full complement of one-year and two-year certificate programs, associate degrees, and bachelor and master degrees, as well as pre-professional academic offerings in a number of fields.

Montana State University-Northern is a regional, multi-purpose educational center, serving students who seek both a technical and liberal arts education. It offers courses at the campus in Havre and at facilities in Great Falls. This campus offers associate, bachelor, and master degrees. A master degree program is offered in education, with options in counseling and development, elementary education, vocational education, and general science.

Montana State University College of Technology-Great Falls was established in 1969 and offers instruction leading to certificates in one-year programs and associate of applied science degrees in two-year programs in vocational-technical trades and industry. Programs include practical nursing, office/secretarial, interior design technology, computer and information sciences, various health-related programs, auto body repair and refinishing, dental hygiene, and business management/entrepreneurship.

A list of Appointed and Administrative Officials having oversight responsibilities with respect to Montana State University can be found beginning on page i.

Beginning on page A-1, you will find the Independent Auditor's Report followed by the financial statements and accompanying notes. We issued an unqualified opinion on the university's consolidated financial statements, which means the reader can rely on the presented information.

This report does not contain any recommendations to the university. Any issues resulting from this financial audit have been discussed with university management. The university's response to this report is on page B-1.

We thank President Gamble and his staff for their cooperation and assistance during the audit.

Respectfully submitted,

Signature on File

Scott A. Seacat
Legislative Auditor

Appointed and Administrative Officials

Board of Regents of Higher Education

Edwin H. Jasmin, Chair
 Christian Hur, Student Regent, Vice Chair
 John Mercer, Regent
 Lynn Morrison-Hamilton, Regent
 Richard Roehm, Regent
 Mark Semmens, Regent
 Lila Taylor, Regent

Judy Martz, Governor*
 Linda McCulloch, Superintendent of Public Instruction*

Office of the Commissioner of Higher Education

Sheila Sterns	Commissioner of Higher Education
Rodger Barber	Acting Deputy Commissioner for Academic and Student Affairs
Rod Sundsted	Associate Commissioner for Fiscal Affairs
Laurie O. Neils	Director of Budget and Accounting

Montana State University-All Campuses

Geoffrey Gamble	President
Virginia Key	Internal Auditor

Montana State University-Bozeman

David Dooley	Provost and Vice President for Academic Affairs
Craig Roloff	Acting Vice President for Administration and Finance
Thomas McCoy	Vice President for Research and Creative Activities
Leslie Taylor	Legal Counsel
Laura Humberger	Controller

Montana State University-Billings

Ronald P. Sexton	Chancellor
Janie C. Park	Provost and Academic Vice Chancellor
Curt Kochner	Interim Vice Chancellor for Student Affairs
Terrie Iverson	Administrative Vice Chancellor
LeAnn Anderson	Director of Financial Services
Jim Nielson	Director of Business Services
Trudy Collins	Budget Officer and Internal Audit

Montana State University-Northern

Alex Capdeville	Chancellor
Cheri Jimeno	Interim Provost and Senior Vice Chancellor
Chuck Jensen	Vice Chancellor Finance & Administration/Student Affairs
Carrie Molitor	Controller

*Ex officio member of the Board of Regents of Higher Education

Appointed and Administrative Officials

**Montana State University
College of Technology –
Great Falls**

Mary Moe
Mary Ellen Baukol
Ed Binkley

Dean
Assistant Dean for Business and Finance
Controller

Members of the audit staff involved in this audit were Jeane Carstensen-Garrett, Alexa O'Dell, and Paul O'Loughlin.

LEGISLATIVE AUDIT DIVISION

Scott A. Seacat, Legislative Auditor
John W. Northey, Legal Counsel



Deputy Legislative Auditors:
Jim Pellegrini, Performance Audit
Tori Hunthausen, IS Audit & Operations
James Gillett, Financial-Compliance Audit

INDEPENDENT AUDITOR'S REPORT

The Legislative Audit Committee
of the Montana State Legislature:

We have audited the accompanying Consolidated Statement of Net Assets of Montana State University, a component unit of the state of Montana, as of June 30, 2003 and 2002, and the related Consolidated Statement of Revenues, Expenses and Changes in Net Assets and Consolidated Statement of Cash Flows for the fiscal years then ended. The information contained in these financial statements is the responsibility of the university's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Montana State University as of June 30, 2003 and 2002, and the results of its operations, and its cash flows for the fiscal years then ended in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis on pages A-3 through A-10 is not a required part of the financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Respectfully submitted,

Signature on File

James Gillett, CPA
Deputy Legislative Auditor

November 21, 2003

**Montana State University's
Management's Discussion and Analysis,
Financial Statements and Notes**

Montana State University

(a component unit of the State of Montana)

Management's Discussion and Analysis

As of and For Each of the Two Years Ended June 30, 2003

Montana State University is a modern, comprehensive land grant university that serves state, national and international communities by providing academic instruction, conducting research and other activities that advance fundamental knowledge, and by disseminating knowledge to the people of Montana. The University encompasses four campuses located in Bozeman, Billings, Great Falls and Havre, as well as the Montana Agricultural Experiment Station, Montana Extension Service and the Fire Services Training School. The University operates throughout Montana's 145,556 square miles of urban and rural communities housing a population of 909,000.

The University and its students are in a unique position. The number of high school graduates in Eastern Montana continues to decrease, which will require the University to modify its mix of traditional in-state, out-of-state, and out-of-area students to ensure a diverse, growing student population. At the same time that the University's student makeup is changing, employee salary and benefit needs continue to grow, and the level of monetary support received from the State has declined. The level of State support is not expected to increase by a significant level in the near future, and may reflect further decline.

Given these significant changes, the University is proud to continue delivering quality services to a diverse student population, which is possible because of its dedicated faculty and staff, because its students recognize quality and value, and because accountability and the wise stewardship of University resources are simply a way of life.

OPERATIONS

Condensed Statements of Revenues, Expenses and Changes in Net Assets

(in millions)

	2003		2002	
	Amount	% of Operating Revenues	Amount	% of Operating Revenues
Operating revenues	\$ 242.3	100.0%	\$ 217.1	100%
Operating expenses	323.7	133.3%	298.0	137.3%
Operating loss	(81.4)	(33.4%)	(80.9)	(37.2%)
Non-operating revenues and expenses (net)	88.3	36.2%	85.9	39.6%
Income before capital items	6.9	2.9%	5.0	2.3%
Capital grants, gains & losses	9.1	3.8%	7.4	3.3%
Change in net assets	\$ 16.0	6.7%	\$ 12.4	5.6%

The **Statement of Revenues, Expenses and Changes in Net Assets** presents the revenues earned and expenses incurred during the year on a full accrual basis, and classifies activities as either "operating" or "non-operating." This distinction results in operating deficits for those institutions that depend on State aid and gifts, which are classified as non-operating revenue. The utilization of capital assets is reflected in the financial statements as depreciation expense, which allocates the cost of assets over their expected useful

lives. The University's net assets increased \$16.0 million during 2003, largely resulting from \$9.1 million in assets received as capital grants, combined with over \$4 million received as additions to the University's permanent endowments.

Operating revenues contain the majority of the University's income, and increased \$25.2 million from 2002 to 2003, largely due to an increase in grant and contract-related revenues of approximately \$14.7 million, or 15.2%.

Montana State University

(a component unit of the State of Montana)

Management's Discussion and Analysis

As of and For Each of the Two Years Ended June 30, 2003

(continued)

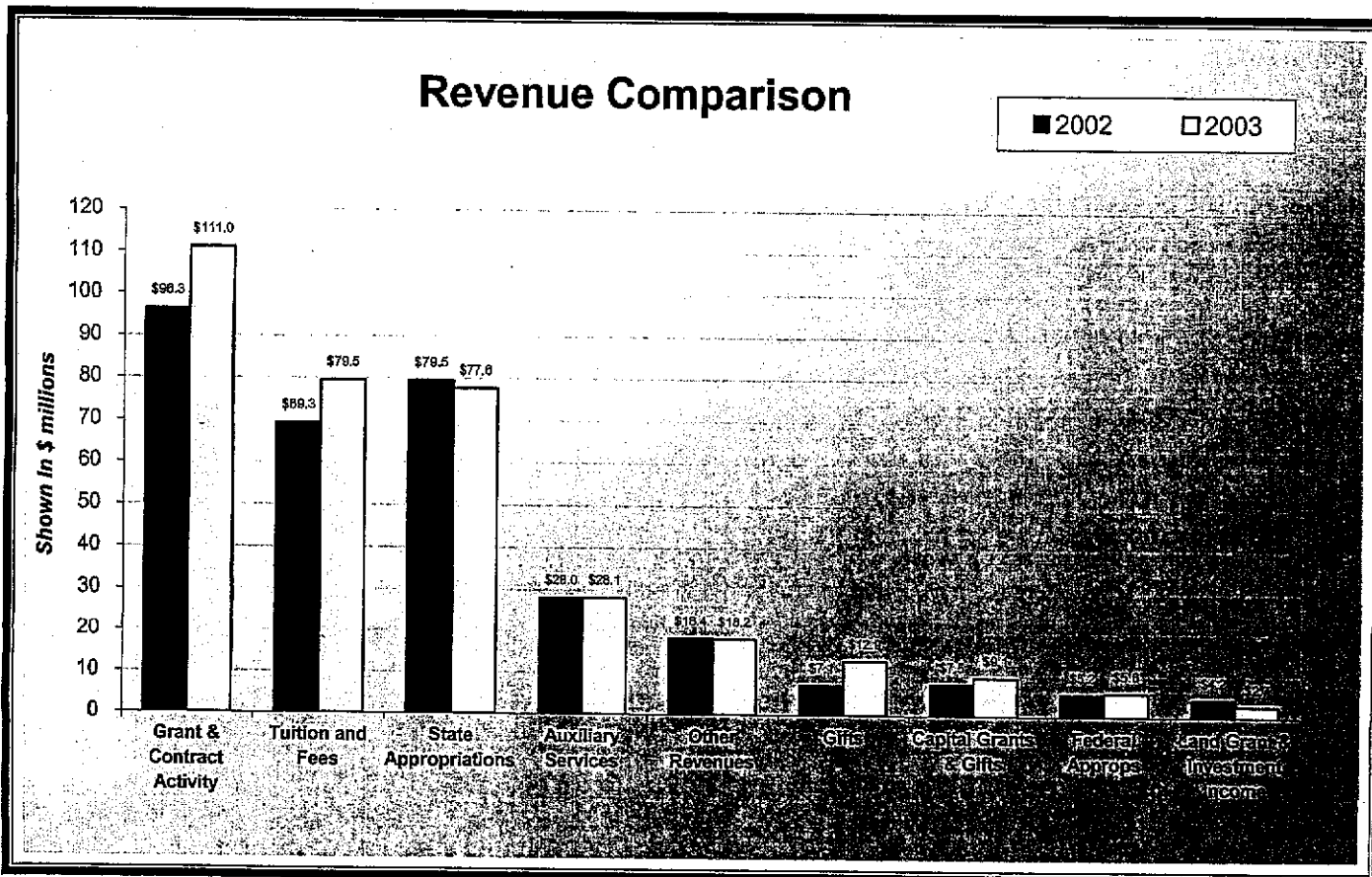
Grant and contract-related revenues include research grants funded by Federal, State and private sponsors, as well as over \$9 million in Federal financial aid. The University maintains a vibrant Research and Creative Activities function that has experienced dramatic growth in the past year. These activities accounted for \$111.0 million in operating revenues during 2003.

Annual Student Enrollment Data (Full Time Equivalent)		
	2003	2002
Montana residents		
Undergraduate	13,130	12,879
Graduate	1,027	1,007
Non-residents		
Undergraduate	2,048	2,007
Graduate	269	231
Western Undergraduate Exchange	661	683
Total	17,135	16,807

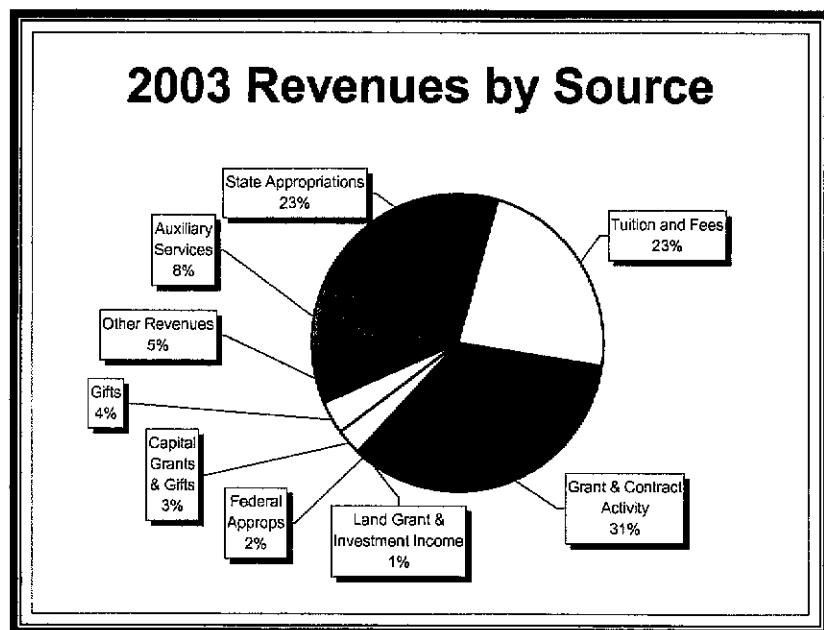
Tuition and fee revenues increased approximately \$10.2 million, or 14.8%. The University's enrollment has increased during each of the past two years, with the most recent academic year representing record enrollment levels. While the number of full-time equivalent students increased 2.0% compared with 2002, the primary reason for increased tuition and fee revenue was an approximate 11.8% average tuition increase.

State appropriations revenue, considered a **non-operating revenue**, decreased from \$79.5 million to \$77.6 million, or 2.4%, a reflection of the difficult economic times faced by the State of Montana as a whole.

Gift revenue, also a non-operating revenue, increased \$5.8 million from 2002 to 2003. The increase resulted primarily from a \$4.2 million estate gift received by the Bozeman campus. The gift represents an addition to the University's permanent endowment fund, and its earnings are restricted to use by the MSU-Bozeman College of Business. The bulk of other gift revenue was received from various University foundations.



During 2003, revenues were derived as follows:

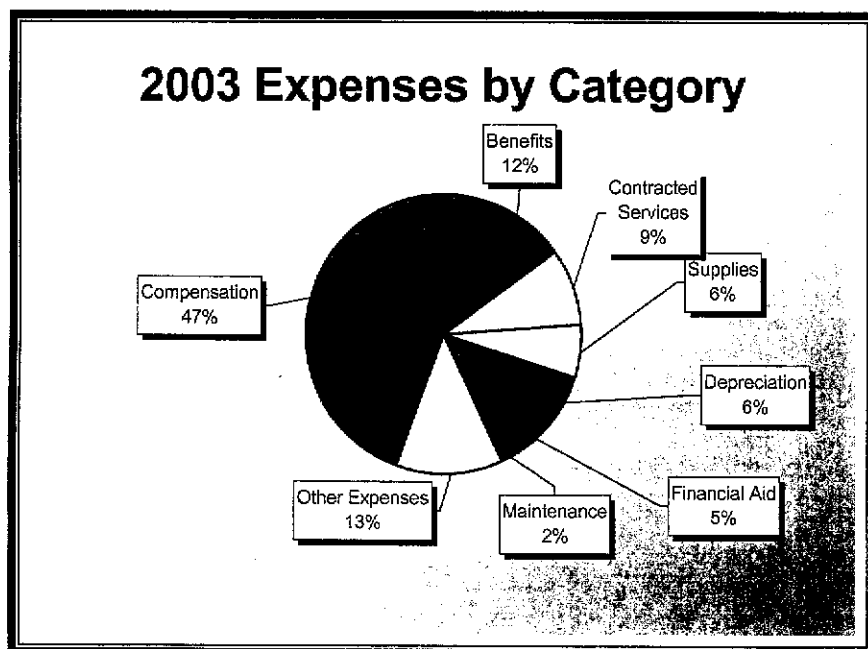


(in millions)

Source	Amount
Grant & Contract Activity	\$ 111.0
Tuition and Fees	79.5
State Appropriations	77.6
Auxiliary Services	28.1
Other Revenues	18.2
Gifts	12.9
Capital Grants & Gifts	9.1
Federal Appropriations	5.6
Land Grant & Investment Income	2.7
Total revenues	\$ 344.7

Sources of recurring revenues are expected to remain strong, with a trend toward higher levels of University-generated revenues.

Expenses were incurred as follows:



(in millions)

Category	Amount
Compensation	\$ 156.0
Benefits	39.3
Contracted Services	29.3
Supplies	20.4
Depreciation	19.6
Financial Aid	15.5
Maintenance	7.4
Other Expenses	
Travel	8.4
Utilities	6.6
Cost of Sales	5.4
Communication	4.6
Interest Expense	4.9
Rent	2.2
Other	9.0
Total expenses	\$ 328.6

Proportions of revenues and expenses have generally remained constant as compared with the prior year. Revenues are derived primarily from student charges, state appropriations and grant and contract activity, while expenses are primarily employee related. These relationships are expected to continue.

Montana State University

(a component unit of the State of Montana)

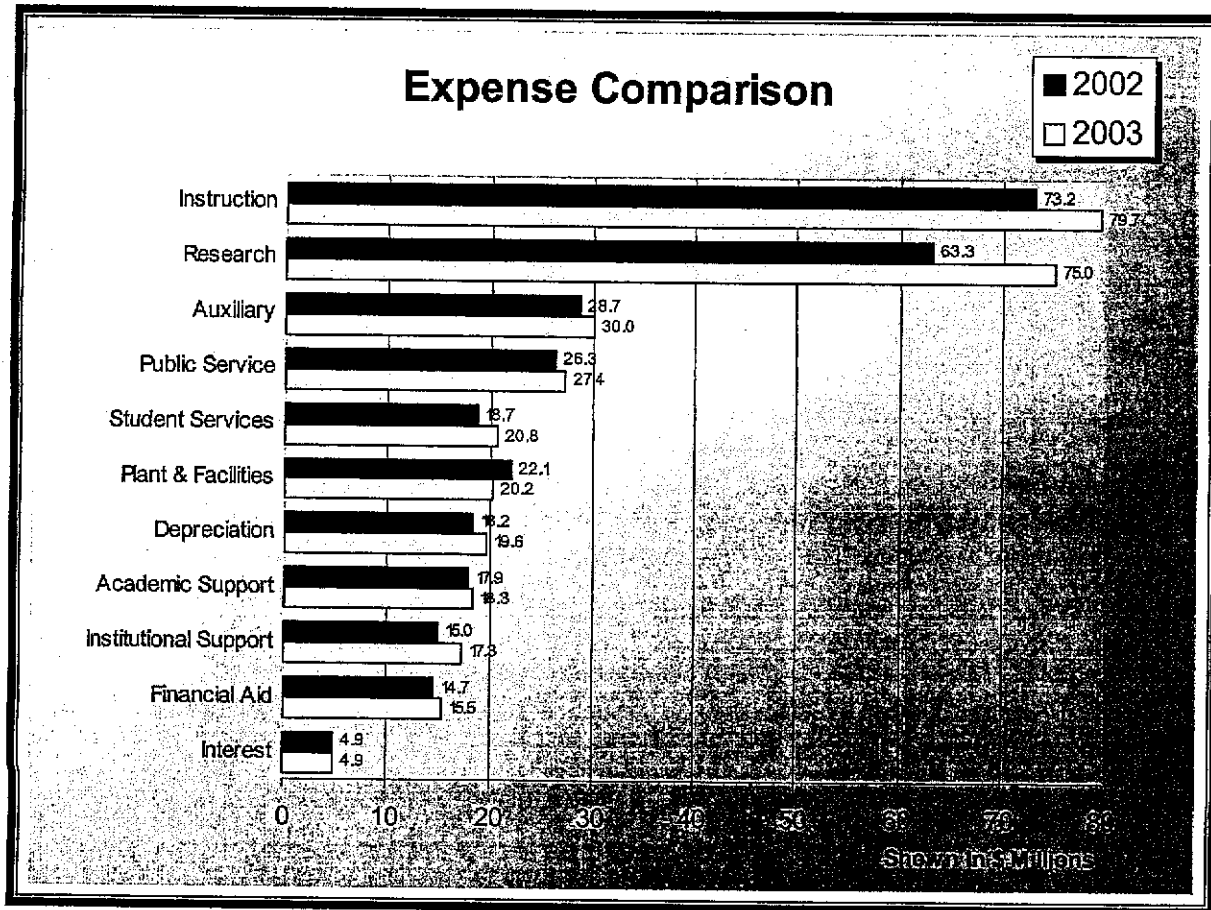
Management's Discussion and Analysis

As of and For Each of the Two Years Ended June 30, 2003

(continued)

Operating expenses increased \$25.7 million, nearly mirroring the increase in revenues. Instruction and research activities together constitute nearly half of the University's expenses, and were the primary programs showing a marked increase, consistent with increased enrollment and a growing research program.

The cost of providing auxiliary services, which is primarily dining and residence hall operations, constitutes the third- largest cost category. Public service, which includes the activities of extension services throughout Montana as well as public television and radio stations and a regional museum, is the fourth- largest program.



In the future, expenditures are expected to rise consistent with increases in enrollment and research activity. Financial aid expense is expected to increase commensurate with increases in the tuition rates, as the University strives to ensure continued access to all qualified students. Interest expense, considered a non-operating expense, is expected to decline as the University pays down its current debt, and takes advantage of refinancing opportunities.

ASSETS, LIABILITIES AND NET ASSETS

The **Statement of Net Assets** is presented in a classified format, which differentiates between current and non-current assets and liabilities, and also categorizes Net Assets (formerly called "Fund Balance") into four categories.

Condensed Statements of Net Assets (in millions)

ASSETS	2003	2002
Current assets	\$ 113.4	\$ 104.3
Capital assets, net	236.8	230.8
Other noncurrent assets	24.4	21.5
Total assets	\$ 374.6	\$ 356.6
LIABILITIES		
Current liabilities	\$ 48.9	\$ 44.5
Noncurrent liabilities	120.8	123.2
Total liabilities	\$ 169.7	\$ 167.7
NET ASSETS		
Invested in capital assets, net	\$ 143.3	\$ 134.1
Restricted, expendable	5.3	4.7
Restricted, non-expendable	9.3	4.6
Unrestricted	47.0	45.5
Total net assets	\$ 204.9	\$ 188.9

Current assets include the University's cash; accounts, grants and loans receivable; inventories; and other assets expected to benefit the University within one year. Accounts and grants receivable result primarily from student accounts and from sponsored projects which are payable on a cost-reimbursement basis. The increase of \$9.1 million in current assets resulted primarily from an increase of \$8.0 million in cash, which is discussed in detail in conjunction with the Statement of Cash Flows.

Capital assets, net increased \$6.0 million, resulting from asset additions of \$26.2 million, offset by depreciation and amortization expense of \$19.6 million and asset retirements of \$0.6 million. Increases included \$9.1 million of construction project additions, a large portion of which was contributed by the State pursuant to its long range building program. In

addition, approximately \$3.3 million in library materials were added, \$8.7 million in furniture and equipment were acquired, and \$2.8 million in buildings and improvements were recorded. Equipment acquisitions related largely to the University's research and instruction programs, and included several donated acquisitions of scientific equipment.

Other noncurrent assets include endowment fund assets, student loans receivable, and investments expected to mature over a period longer than one year. The balance increased \$2.9 million, which included an increase of \$4.7 million in endowment balances, offset by a \$1.5 million decrease in the long-term portion of student loans receivable. Endowment funds increased due to a large estate gift received by the Bozeman campus. The decrease in long-term student loans receivable was largely offset by an increase in the short-term portion of loans receivable, and represents a change in the expected timing of repayments.

Current liabilities include payroll and related liabilities, amounts payable to suppliers for goods and services received, cash received for which the University has not yet earned the related revenue, and debt principal payments due within one year. The balance increased \$4.4 million, resulting from increased payroll and related liabilities of \$2.4 million, and increased compensated absence liabilities of \$0.7 million. Payroll-related liabilities increased due to the overall increase in the University's compensation and benefit expense.

Noncurrent liabilities include debt principal payments and the amount of compensated absence liability estimated to be payable after a one-year period, as well as amounts which would be payable to the Federal government should the University choose to cease participation in the Federal Perkins Loan or Nursing Loan programs. These balances decreased \$2.4 million, due primarily to scheduled repayments of bond principal.

Montana State University

(a component unit of the State of Montana)

Management's Discussion and Analysis

As of and For Each of the Two Years Ended June 30, 2003

(continued)

Amounts **invested in capital assets, net of related debt**, consist of the historical acquisition value of capital assets, reduced by both accumulated depreciation expense charged against assets and debt balances related to capital assets. This balance increases as assets are acquired and debt is repaid, and decreases as assets are depreciated and debt is incurred.

Restricted, expendable net assets represent balances that may be expended by the University, but only in accordance with restrictions imposed upon the University by an external party, such as a donor or through a legislative mandate. The University's most significant restricted, expendable balance relates to funds held by trustees in accordance with bond covenants, which may only be expended for the renewal and replacement of assets whose revenues are pledged as security for the repayment of debt.

Restricted, non-expendable balances must be held in perpetuity, and include endowment principal as well as the University portion of student loans receivable under the Federal Perkins and Nursing Loan programs.

Unrestricted net assets may be designated for specific purposes by action of management or the Board of Regents, or may otherwise be limited by contractual agreements with outside parties. Substantially all unrestricted net assets are designated for specific purposes as described in the notes to the financial statements, and include funds accumulated for grant-funded employee termination payouts, funds earmarked for facility renewal and replacement, and student organization funds.

CASH FLOWS

Condensed Statements of Cash Flows

(in millions)

	2003	2002
Cash provided/(used) by:		
Operating activities, net	\$ (56.2)	\$ (60.3)
Noncapital financing activities, net	92.1	87.3
Capital and related financing activities, net	(24.6)	(20.7)
Investing activities, net	(3.4)	3.0
Net increase in cash	7.9	9.3
Cash, beginning of year	74.9	65.6
Cash, end of year	\$ 82.8	\$ 74.9

The **Statement of Cash Flows** presents information related to cash inflows and outflows, categorized by operating, noncapital financing, capital financing, and investing activities. The reconciliation of operating loss to cash used in operations explains the relationship between the Statement of Net Assets and the Statement of Revenues, Expenses and Changes in Net Assets, showing that increases and decreases in operating assets often require the use or receipt of cash, but do not result in recognition of a revenue or an expense.

A \$7.9 million increase in cash and equivalents was generated on \$6.9 million of "Income before other revenues, expenses, gains and losses" as reported in the accompanying Statement of Revenues, Expenses and Changes in Net Assets. During the prior year, a \$9.3 million increase in cash and equivalents was generated on \$5.0 million of "Income before other revenues, expenses, gains and losses."

Operating activities used \$56.2 million in cash, resulting primarily from an operating loss of \$81.4 million. The operating loss was offset by non-cash expenses of \$20.5 million, (primarily depreciation and amortization) as well increased funds of \$4.7 million.

- Cash on hand as of June 30th required to fund payroll and related liabilities, payable during the first two weeks of July, increased \$3.0 million as compared with the prior June 30th due to increased compensation-related expenses.

Montana State University

(a component unit of the State of Montana)

Management's Discussion and Analysis

As of and For Each of the Two Years Ended June 30, 2003

(continued)

- Research-related funds, including indirect cost recoveries, increased \$1.1 million, corresponding to the increase in grant activity experienced during 2003.
- Accounts receivable balances (gross) decreased \$0.6 million, largely due to cash collected upon implementation of a more aggressive collection plan.
- Other, less significant, increases and decreases also contributed to the change in operating cash.

In the prior year, operating activities used \$60.3 million in cash, resulting primarily from an operating loss of \$80.9 million. The operating loss was offset by non-cash expenses of \$18.9 million, (primarily depreciation and amortization) as well increased funds of \$1.8 million resulting from changes in operating assets and liabilities.

Noncapital financing activities provided \$92.1 million in cash, resulting from \$77.6 million in state appropriations, \$1.6 million of land grant income, and \$12.9 million of gift income. In the prior year, noncapital financing activities provided \$87.3 million in cash, resulting from \$79.5 million in state appropriations, \$1.5 million of land grant income, and \$7.1 million of gift income, as well as other, less significant sources and uses of cash.

Capital and related financing activities used \$24.6 million in cash, resulting primarily from \$16.5 million expended to acquire capital assets, \$4.6 million in debt principal payments, and \$5.4 million in cash paid for interest, primarily related to bond indebtedness. In the prior year, these activities used \$20.7 million in cash, resulting from \$11.4 million expended to acquire capital assets, \$4.7 million in debt principal payments, and \$5.4 million in cash paid for interest.

Investing activities used \$3.4 million. Cash of \$4.7 million, most of which had been received in the form of an estate gift, and is shown as a cash inflow in "Noncapital financing activities," was used to purchase long-term investments, and as such is considered a use of cash for investing purposes. This use of cash was offset by investment earnings of \$1.2 million. In the prior year, investing activities provided \$2.9 million, consisting of investment earnings. The reduction in investment earnings results from low yields on funds held in the State of Montana's short-term investment pool.

BONDS, NOTES, AND CAPITAL LEASES

As of June 30, 2003, the University had approximately \$93.5 million in outstanding bonds, notes, and capital lease principal, a decrease of \$3.3 million compared with June 30, 2002. The change resulted from new borrowings of \$1.8 million, bond discount amortization of \$0.5 million, and repayments of \$5.5 million.

On October 15, 2003, the University issued \$18,760,000 in Municipal Auction Rate Securities as Series 2003 G Revenue Bonds. Of this total, \$16,745,000 was used for a current refunding of the Series 1993-A bonds and \$2,015,000 was used for an advance refunding of the Series 1994 C bonds. The new bonds are ten year variable rate bonds, priced on a 35-day rate period. They are unconditionally and irrevocably guaranteed by XL Capital Assurance. The bonds were issued in denominations of \$25,000, with principal repayments scheduled each May 15 and November 15 through November, 2016. Bond proceeds, along with monies from the University, were sufficient to legally defease that portion of the Series 1993 A bonds that were called, and the Series 1994 C bonds that will be called on November 15, 2004.

ECONOMIC OUTLOOK

The State of Montana continues to experience economic uncertainty, which affects the University's level of available State funding. The State of Montana Legislative Fiscal Report for the 2005 Biennium, prepared by the Legislative Fiscal Division, discusses "structural balance" as the matching of *ongoing* revenues with *ongoing* expenditures. In the recent past, the University has strived to achieve structural balance by combining spending

Montana State University

(a component unit of the State of Montana)

Management's Discussion and Analysis

As of and For Each of the Two Years Ended June 30, 2003

(continued)

reductions with increased revenues, to maintain quality programs in light of flat or decreased available State funding.

Recent revenue increases have been achieved through several means: the growth of grant and contract activity; increases in tuition rates charged to students, which will likely continue at a steady, predictable level; careful monitoring and management of the mix of in-state and out-of-state students, whose tuition rates differ; and continued encouragement of the entrepreneurial spirit maintained by many University faculty and staff.

The U.S. Census Bureau projects that, over the next 20 years, the population of Montanans ages 18 – 24 will decrease steadily, showing an approximate 10% overall decrease. In light of this trend, continued monitoring and management of the University's out-of-state student population is crucial.

To assist in the allocation of its resources, management evaluates University programs regularly, and maintains a budgeting process that is open to the public. Accountability and stewardship of the University's assets are stressed by top management, as is excellence in the programs offered. University management will continue to determine the proper balance between spending cuts and revenue increases, to ensure that quality programs remain while access to the University is not unduly limited by the cost of attendance.

Montana State University
a component unit of the State of Montana
Consolidated Statements of Net Assets
As of June 30

ASSETS	2003	2002
Current assets:		
Cash and cash equivalents	\$ 81,895,206	\$ 73,900,559
Accounts and grants receivable, net	7,203,919	8,258,081
Amounts receivable from Federal government	13,303,535	12,405,130
Amounts receivable from primary government	1,159,718	1,360,269
Amounts receivable from other State of Montana Component Units	22,326	-
Loans receivable, net	4,228,273	3,353,199
Inventories	3,009,439	2,876,093
Prepaid expenses and other current assets	2,597,090	2,185,318
Total current assets	113,419,506	104,338,649
Noncurrent assets:		
Restricted cash and cash equivalents	940,586	1,014,927
Restricted investments	5,133,614	391,144
Loans receivable, net	16,223,813	17,764,998
Investments	2,141,975	2,261,096
Capital assets, net (see note 7)	236,768,452	230,818,939
Total noncurrent assets	261,208,440	252,251,104
Total assets	\$ 374,627,946	\$ 356,589,753
LIABILITIES		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 21,906,619	\$ 19,006,498
Amounts payable to primary government	987,809	1,269,926
Amounts payable to other State of Montana component units	338,381	-
Property held in trust for others	876,175	737,636
Deferred revenues	8,971,103	8,485,828
Compensated absences	10,642,125	9,874,833
Current portion debt and capital lease obligations (note 10)	5,168,332	5,142,976
Total current liabilities	48,890,544	44,517,697
Noncurrent liabilities:		
Debt and capital lease obligations (note 10)	88,299,365	91,589,985
Compensated absences	12,254,032	11,798,722
Due to Federal government	20,254,326	19,812,258
Total noncurrent liabilities	120,807,723	123,200,965
Total liabilities	169,698,267	167,718,662
NET ASSETS		
Invested in capital assets, net of related debt	143,300,755	134,085,987
Restricted - nonexpendable:		
Endowments	6,074,199	1,407,166
Loans	3,267,052	3,207,611
Restricted - expendable:		
Scholarships	297,961	670,299
Research and other	1,430,603	744,992
Loans	189,365	184,791
Renewal and replacement of plant facilities	3,045,471	2,907,834
Debt retirement	321,754	179,815
Unrestricted (note 13)	47,002,519	45,482,596
Total net assets	204,929,679	188,871,091
Total liabilities and net assets	\$ 374,627,946	\$ 356,589,753

The accompanying notes are an integral part of these financial statements.

Montana State University

a component unit of the State of Montana

Consolidated Statements of Revenues, Expenses and Changes in Net Assets

As of and for Each of the Two Years Ended June 30

	2003	2002
OPERATING REVENUES		
Tuition and fees (net of \$17,223,007 and \$11,452,696 scholarship discount); (\$5,232,010 and \$4,862,827 are pledged for repayment of bonds)	\$ 79,491,455	\$ 69,257,991
Federal appropriations	5,621,121	5,194,913
Federal grants and contracts	81,012,750	70,196,554
State grants and contracts	6,396,530	5,448,704
Non-governmental grants and contracts	9,999,146	9,668,737
Indirect cost recoveries	13,568,037	10,994,742
Educational, public service and outreach revenues	17,005,161	17,757,040
Auxiliary revenues:		
Housing (net of \$1,223,419 and \$926,228 scholarship discount), (\$1,511,536 and \$1,550,049 net revenues are pledged for repayment of bonds)	11,116,267	11,052,769
Food services (net of \$1,320,205 and \$1,013,062 scholarship discount), (\$1,706,797 and \$1,653,196 net revenues are pledged for repayment of bonds)	10,340,616	10,383,683
Other auxiliary sales and services (net of \$1,271,273 and \$955,173 scholarship discount), (\$87,595 and \$380,725 net losses are pledged for repayment of bonds)	6,630,123	6,585,834
Interest earned on loans	85,542	34,431
Other operating revenues	1,080,765	572,906
Total operating revenues	242,347,513	217,148,304
OPERATING EXPENSES		
Compensation and benefits	195,225,126	180,434,160
Operating expenses (Note 14)	93,377,338	84,679,602
Scholarships and fellowships (net of \$21,037,904 and \$14,347,159 scholarship discount)	15,501,298	14,674,569
Depreciation and amortization	19,627,347	18,247,814
Total operating expenses	323,731,109	298,036,145
Operating loss	(81,383,596)	(80,887,841)
NONOPERATING REVENUES (EXPENSES)		
State appropriations	77,594,407	79,497,987
Land grant income (pledged as security for repayment of bonds)	1,551,616	1,467,092
Gifts	12,922,722	7,132,230
Investment income (\$276,074 and \$774,267 are pledged as repayment of bonds)	1,132,768	2,689,100
Interest expense	(4,897,408)	(4,916,447)
Net nonoperating revenues (expenses)	88,304,105	85,869,962
Income before other revenues, expenses, gains and losses	6,920,509	4,982,121
Gain (loss) on disposals of capital assets	(457,354)	92,562
Capital grants and contributions	9,595,433	7,367,052
Change in net assets	16,058,588	12,441,735
Net assets, beginning of year, as previously stated	188,871,091	403,974,201
GASB 35 asset adjustment (primarily infrastructure capitalization)	-	20,229,326
GASB 35 adjustment to record accumulated depreciation	-	(222,669,833)
GASB 35 summer session adjustment	-	1,267,271
GASB 35 adjustment reclassifying the federal portion of loan programs	-	(19,381,963)
GASB 35 deferred revenue adjustment for grants and contracts	-	(6,019,341)
Other additions to and decreases from net assets	-	(970,305)
Net assets, beginning of year, as restated	188,871,091	176,429,356
Net assets, end of year	\$ 204,929,679	\$ 188,871,091

The accompanying notes are an integral part of these financial statements.

Montana State University
a component unit of the State of Montana
Consolidated Statements of Cash Flows
As of and For the Year Ended June 30

	2003	2002
Cash flows from operating activities:		
Operating revenues:		
Tuition and fees	\$ 79,146,224	\$ 70,801,448
Federal appropriations	5,289,016	5,194,913
Federal grants and contracts	80,126,424	66,407,599
State grants and contracts	7,971,921	7,903,711
Private grants and contracts	9,474,104	10,029,012
Indirect cost recoveries	13,450,989	11,071,132
Educational, public service and outreach revenues	17,552,426	15,478,827
Sales and services of auxiliary enterprises	28,120,760	30,933,678
Interest on loans receivable	527,610	464,727
Other operating receipts	1,080,765	572,906
Operating expenses:		
Compensation and benefits	(191,613,330)	(179,740,291)
Operating expenses	(92,487,781)	(83,616,103)
Scholarships and fellowships	(15,501,298)	(14,674,569)
Loans made to students	(3,201,999)	(4,389,083)
Loan payments received	3,868,109	3,271,743
Net cash used in operating activities	(56,196,060)	(60,290,350)
Cash flows from noncapital financing activities:		
Receipts (disbursements) of funds held in trust for others	64,750	(772,266)
Direct lending proceeds	35,716,447	29,200,008
Direct lending disbursements	(35,716,447)	(29,200,008)
State appropriations	77,594,407	79,497,987
Gifts and contributions	12,922,722	7,132,229
Land grant income (Note 2)	1,551,616	1,467,092
Net cash provided by noncapital financing activities	92,133,495	87,325,042
Cash flows from capital financing activities:		
Purchase of capital assets	(16,452,831)	(11,406,057)
Proceeds from sale of capital assets	128,031	92,562
Proceeds from borrowings	1,663,972	730,288
Debt repayment	(4,560,990)	(4,711,837)
Interest paid	(5,410,680)	(5,407,492)
Net cash used in capital financing activities	(24,632,498)	(20,702,536)
Cash flows from investing activities:		
Purchase of investments	(32,023)	(151,599)
Proceeds from sale of investments	151,145	217,915
Investment income	1,238,717	2,857,578
Sales (purchases) of restricted investments	(4,742,470)	33,610
Net cash provided by (used in) investing activities	(3,384,631)	2,957,504
Net change in cash and cash equivalents	7,920,306	9,289,660
Cash balances at beginning of year	74,915,486	65,625,826
Cash balances at end of year	\$ 82,835,792	\$ 74,915,486

The accompanying notes are an integral part of these financial statements.

Montana State University
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Consolidated Statements of Cash Flows (continued)
As of and For the Year Ended June 30

Reconciliation of Operating Loss to Net Cash Used in Operations

	<u>2003</u>	<u>2002</u>
Operating loss	\$ (81,383,596)	\$ (80,887,841)
Non-cash income and expense:		
Depreciation and amortization	19,627,347	18,247,814
Provision for uncollectible accounts	836,440	675,284
Changes in operating assets and liabilities:		
Accounts and grants receivable	(534,614)	4,920,811
Loans receivable	666,110	(1,117,340)
Inventories	(133,346)	(896,534)
Prepaid expenses	(411,772)	(435,873)
Accounts payable and other accrued liabilities	2,987,426	(2,347,266)
Deferred revenue	485,275	(287,647)
Compensated absences	1,222,602	1,407,946
Due to federal government	442,068	430,296
Net cash used in operating activities	\$ (56,196,060)	\$ (60,290,350)

Schedule of noncash financing and investing activities

	<u>2003</u>	<u>2002</u>
Capital assets contributed to the University	\$ 9,595,433	\$ 7,367,052
Capital assets acquired through issuance of capital lease obligations	\$ 113,982	\$ 492,089
Bond discount amortized to interest expense	\$ 482,230	\$ 458,521

Reconciliation of cash and cash equivalents as shown on the Statements of Cash Flows to Cash as Shown in the Statements of Net Assets

	<u>2003</u>	<u>2002</u>
Cash and cash equivalents classified as current assets	\$ 81,895,206	\$ 73,900,559
Cash and cash equivalents classified as non-current assets	940,586	1,014,927
Total cash and cash equivalents as reported on the Statements of Cash Flows	\$ 82,835,792	\$ 74,915,486

The accompanying notes are an integral part of these financial statements.

Montana State University
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Notes to Consolidated Financial Statements
As of and for Each of the Two Years Ended June 30, 2003

NOTE 1 – ORGANIZATION, BASIS OF PRESENTATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

ORGANIZATION

The accompanying financial statements include all activities of the four Montana State University campuses, the Montana Agricultural Experiment Station, Montana Extension Service and the Fire Services Training School, collectively referred to as the "University." The four campuses of the University are Montana State University–Bozeman, Montana State University–Billings, Montana State University–Northern (located in Havre) and Montana State University College of Technology–Great Falls. Significant interagency transactions have been eliminated in consolidation.

The University is a modern comprehensive land grant university that serves the state, national and international communities by providing its students with academic instruction, conducting research and other activities that advance fundamental knowledge, and by disseminating knowledge to the people of Montana.

A financial reporting entity, as defined by Governmental Accounting Standards Board ("GASB") Statement No. 14, *The Financial Reporting Entity*, consists of the primary government, organizations for which the primary government is financially accountable and other organizations for which the nature and significance of their relationship with the primary government are such that exclusion could cause the financial statements to be misleading or incomplete. Accordingly, the financial statements for the University are included as a component unit of the State of Montana Basic Financial Statements, which are prepared annually and presented in the Montana Comprehensive Annual Financial Report (CAFR).

Accounts of University foundations and other affiliated organizations, such as booster and alumni organizations, are not controlled by the University and are not included in the accompanying financial statements. (See Note 18 regarding related party transactions.)

BASIS OF PRESENTATION

In June 1999, the GASB issued Statement No. 34, *Basic Financial Statements and Management Discussion and Analysis for State and Local Governments*. This was followed in November, 1999 by GASB Statement No. 35, *Basic Financial Statements and Management's Discussion and Analysis for Public Colleges and Universities*. The State of Montana implemented GASB Statement No. 34 as of and for the year ended June 30, 2002. As a component unit of the State of Montana, the University was also required to adopt GASB Statements No. 34 and No. 35. The latter statement was adopted as amended by GASB Statements No. 37 and No. 38. During the year ended June 30, 2002, the University also adopted GASB Statement No. 33, *Accounting and Financial Reporting for non-exchange Transactions*.

The financial statement presentation required by GASB Statements No. 34 and No. 35 provides a comprehensive, entity-wide perspective of the University's assets, liabilities, net assets, revenues, expenses, changes in net assets, and cash flows, and replaces the fund-group perspective previously required.

Significant accounting changes that were made to comply with the new requirements included (1) adoption of depreciation on capital assets and capitalizing infrastructure assets; (2) allocating summer school revenues and expenses among fiscal years rather than reporting each summer in one fiscal year; (3) reporting of tuition and fees and other student revenues, as well as scholarship and fellowship expense, net of scholarship discounts and allowances; and (4) deferring the recognition of grant or contract revenue until funds received have been expended for their restricted purpose.

For financial reporting purposes, the University is considered a special-purpose government engaged only in business-type activities. Business-type activities are those that are financed in whole or in part by fees charged to external parties for goods or services. Accordingly, the University's financial statements have been prepared using the economic resources measurement focus and the accrual basis of accounting. Under the accrual basis, revenues are recognized when earned, and expenses are recorded

Montana State University
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Notes to Consolidated Financial Statements
As of and for Each of the Two Years Ended June 30, 2003
(continued)

when an obligation has been incurred. The University has the option to apply all Financial Accounting Standards Board (FASB) pronouncements issued after November 30, 1989, unless FASB conflicts with GASB. The State of Montana has elected not to apply FASB pronouncements issued after the applicable date.

SIGNIFICANT ACCOUNTING POLICIES

Cash equivalents – For purposes of the statement of cash flows, the University considers its unrestricted, highly liquid investments purchased with an original maturity of three months or less to be cash equivalents. Funds invested in the Short Term Investment Pool with the Montana Board of Investments are considered cash equivalents, as are certain investments held by trustees.

Investments – The University accounts for its investments at fair value in accordance with GASB Statement No. 31 *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*. Investment income is recorded on the accrual basis. All investment income, including changes in unrealized gain (loss) on the carrying value of investments, is reported as a component of investment income.

Accounts and grants receivable – Accounts receivable consist of tuition and fees charged to students and auxiliary enterprise services provided to students, faculty and staff. Accounts receivable also include amounts due from the Federal government, state and local governments, or private sources, in connection with reimbursement of allowable expenditures made pursuant to the University's grants and contracts. Accounts receivable are reported net of estimated uncollectable amounts.

Allowances for uncollectable accounts – The University estimates the value of its receivables that will ultimately prove uncollectable, and has reported a provision for such as an expense in the accompanying financial statements.

Inventories – Inventories include consumable supplies, livestock, and food items and items held for resale or recharge within the University. Inventories are valued using First In First Out (FIFO) or specific identification methods.

Non-current cash and investments – Cash and investments that are externally restricted as to use are classified as non-current assets in the accompanying statement of net assets. Such assets include endowment fund cash and investments.

Capital assets – Capital assets are stated at cost or fair value at date of purchase or donation. Livestock held for educational purposes is recorded at estimated fair value. Renovations to buildings, infrastructure, and land improvements that significantly increase the value or extend the useful life of the structure are capitalized. Routine repairs and maintenance and minor renovations are charged to operating expense in the year in which the expense is incurred.

Depreciation and amortization are computed on a straight-line basis over the estimated useful lives of the respective assets, ranging from 3 years for certain software to 75 years for certain infrastructure assets. The University has elected to capitalize museum, fine art and special library collections, but does not record depreciation on those items.

Deferred revenues – Deferred revenues include amounts received for tuition and fees and certain auxiliary activities prior to the end of the fiscal year but related to events occurring in the subsequent accounting period. Deferred revenues also include amounts received from grant and contract sponsors that have not yet been earned.

Compensated absences – Eligible University employees earn a minimum of 8 hours sick and 10 hours annual leave for each month worked. Eligible employees may accumulate annual leave up to twice their

Montana State University
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Notes to Consolidated Financial Statements
As of and for Each of the Two Years Ended June 30, 2003
(continued)

annual accrual, while sick leave may accumulate without limitation. Twenty-five percent of accumulated sick leave earned after July 1, 1971 and 100 percent of accumulated annual leave, if not used during employment, is paid upon termination.

Net assets – Resources are classified in one of the following four net asset categories:

Invested in capital assets, net of related debt – this represents the University's total investment in capital assets, net of accumulated depreciation and outstanding principal balances of debt attributable to the acquisition, construction or improvement of those assets.

Restricted net assets, nonexpendable – this represents net assets subject to externally imposed stipulations that the University maintain those assets permanently. Such assets include the University's permanent endowment funds.

Restricted net assets, expendable – this represents net assets whose use by the University is subject to externally imposed stipulations as to either the use or the period of availability of the assets.

Unrestricted net assets – this represents net assets that are not subject to externally imposed stipulations. Unrestricted net assets may be designated for specific purposes by action of management or the Board of Regents or may otherwise be limited by contractual agreements with outside parties. Substantially all unrestricted net assets are designated for specific purposes as described in Note 13.

Classification of revenues – The University has classified its revenues as either operating or non-operating according to the following criteria:

Operating revenues – include activities that have the characteristics of exchange transactions, including (1) student tuition and fees, net of scholarship discounts and allowances, (2) sales and services of auxiliary enterprises, net of scholarship discounts and allowances, (3) most Federal, state and local grants and contracts and Federal appropriations, and (4) interest on institutional student loans.

Non-operating revenues – include activities that have the characteristics of non-exchange transactions, such as gifts and contributions, and other revenue sources that are defined as non-operating revenues by GASB No. 9, *Reporting Cash Flows of Proprietary and Nonexpendable Trust Funds and Governmental Entities That Use Proprietary Fund Accounting*, and GASB No. 34, such as state appropriations and investment income.

Use of restricted revenues – When the University maintains both restricted and unrestricted funds for the same purpose, the order of use of such funds is determined on a case-by-case basis. Restricted funds remain classified as restricted until they are expended.

Income taxes – The University, as a political subdivision of the State of Montana, is excluded from Federal income taxes under Section 115(1) of the Internal Revenue Code, as amended. Certain activities of the University may be subject to taxation as unrelated business income under Internal Revenue Code Sections 511 to 514. Because tax liabilities are not considered to be material, no provision for income tax expense is reported in the accompanying financial statements.

Scholarship discounts and allowances – Student tuition and fee revenues, and certain other revenues from students, are reported net of scholarship discounts and allowances in the statement of revenues, expenses, and changes in net assets. Scholarship discounts and allowances are computed as the difference between the stated charge for goods and services provided by the University, and the amount that is paid by students and/or third parties making payments on the students' behalf. Certain governmental grants, such as

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Notes to Consolidated Financial Statements
As of and for Each of the Two Years Ended June 30, 2003
(continued)

Pell grants, and other Federal, state or nongovernmental programs, are recorded as operating revenues in the University's financial statements. To the extent that revenues from such programs are used to satisfy tuition and fees and other student charges, the University has recorded a scholarship discount and allowance.

Accounting changes – In prior years, the financial information of the Bozeman and Great Falls campuses, as well as the Montana Agricultural Experiment Station, Montana Extension Service and the Fire Services Training School, was presented in a consolidated format, while the Billings and Havre campuses each presented separate audited financial statements. Beginning with the fiscal year ended June 30, 2002, the University prepared one set of consolidated financial statements, including all campuses and agencies, to better reflect the University's organizational structure. The ending net asset balances for the previously-consolidated campuses and agencies as reported at June 30, 2001, totaled \$326,725,519. As a result of the change in reporting entity, July 1, 2001 net asset balances as reported in the accompanying statements total \$403,974,201. In the accompanying consolidated financial statements, the 2002 increase in the University's net assets equals \$12,441,734. The operations of the Billings and Havre campuses contributed \$2,645,752 to the increase.

In May of 2002, the GASB issued Statement No. 39, "Determining Whether Certain Organizations Are Component Units," which is effective for fiscal years beginning after June 15, 2003, and amends Statement No. 14, "The Financial Reporting Entity." The University has not yet determined which of its support organizations qualify for inclusion as a component unit subject to the provisions of Statement No. 39.

Reclassifications – Certain prior year amounts have been reclassified to conform with the current year presentation.

NOTE 2 – CASH, CASH EQUIVALENTS, AND INVESTMENTS

Cash equivalents – These amounts consist of cash held by trustees as well as in the Short Term Investment Pool (STIP) with the Montana Board of Investments. STIP investments are purchased in accordance with the statutorily mandated "Prudent Expert Principle." The STIP portfolio may include asset-backed securities, banker's acceptances, certificates of deposit, commercial paper, corporate and government securities, repurchase agreements and variable rate securities to provide diversification and a competitive rate of return. Cash equivalents are classified as Risk Category #1.

Investments – The University's investments are categorized as to credit risk as either Category I insured or registered, or securities held by the University or its agent in the University's name or other investments not categorized.

Fair Value of Cash Equivalents and Investments as of June 30,

	2003	2002
Category I - U.S. Government securities	\$ 47,149,868	\$ 41,331,446
Not Categorized - Foundation Pools	4,979,430	511,158
Total Cash Equivalents and Investments	\$ 52,129,298	\$ 41,842,604

The cost basis of investments held by the State of Montana Board of Investments were \$44,128,521 and \$38,463,497 as of June 30, 2003 and 2002. The cost basis of investments held by trustees were \$7,883,493 and \$3,288,527 as of June 30, 2003 and 2002.

Asset-backed securities are collateralized by non-mortgage assets pledged by the issuer and have one or more forms of credit enhancement to raise the quality of the security.

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Notes to Consolidated Financial Statements
As of and for Each of the Two Years Ended June 30, 2003
(continued)

The Foundation Pool consists of certain endowment funds held in common investment pools administered by the MSU-Bozeman and MSU-Northern Foundations.

Securities lending transactions – Under the provisions of state statutes, the Board of Investments has, via a Securities Lending Authorization Agreement, authorized the custodial bank, State Street Bank and Trust, to lend the Board's securities to broker-dealers and other entities with a simultaneous agreement to return the collateral for the same securities in the future. During the period the securities are on loan, the Board receives a fee and the custodial bank must initially receive collateral equal to 102 percent of the market value of the loaned securities and maintain collateral equal to not less than 100 percent of the market value of the loaned security. The Board retains all rights and risks of ownership during the loan period.

During fiscal years ending June 30, 2003 and 2002, the Board and the borrowers maintained the right to terminate all securities lending transactions on demand. The cash collateral received on each loan was invested, together with the cash collateral of other qualified plan lenders, in a collective investment pool, the Securities Lending Quality Trust. The relationship between the average maturities of the investment pool and the Board's loans was affected by the maturities of the loans made by other plan entities that invested cash collateral in the collective investment pool, which the Board could not determine. As of June 30, 2003 and 2002, the board had no credit risk exposure to borrowers, and the University maintained no security lending cash collateral.

Land grant earnings – The University benefits from two separate land grants, totaling 240,000 acres. The first granted 90,000 acres for the University under provisions of the Morrill Act of 1862. The second, under the Enabling Act of 1889, granted an additional 50,000 acres for agricultural institutions and 100,000 acres for state normal schools.

Under provisions of both grants, income from the sale of land and land assets must be reinvested and constitutes, along with the balance of the unsold land, a perpetual endowment fund. The State of Montana, Board of Land Commissioners, administers both grants and holds all endowed assets. The University's land grant assets are not reflected in these financial statements, but are included as a component of the State of Montana Basic Financial Statements that are prepared annually and presented in the Montana CAFR.

Investment income from the perpetual endowment is distributed periodically to the University by the State of Montana, Board of Land Commissioners, and is reported as revenue in the accompanying financial statements. The University has currently pledged such income to the retirement of revenue bond indebtedness.

In addition to distributed endowment income, the University also receives revenue generated from trust land timber sales. The University has designated these revenues for re-investment, but has the flexibility to remove this designation, should it choose to expend the funds for certain specified purposes.

Off-balance sheet risk – The University's investment strategy incorporates certain financial instruments that involve, to varying degrees, elements of market risk and credit risk in excess of amounts reported in the financial statements. Market risk is the potential for changes in the value of financial instruments due to market changes, including interest and foreign exchange rate movements and fluctuations embodied in forward, futures, commodity or security prices. Market risk is directly impacted by the volatility and liquidity of the markets in which the related underlying assets are traded. Credit risk is the possibility that a loss may occur due to the failure of a counter party to perform according to the terms of the contract. The University's risk of loss in the event of counter party default is limited to the amounts recognized in the statement of net assets.

Montana State University
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Notes to Consolidated Financial Statements
As of and for Each of the Two Years Ended June 30, 2003
(continued)

NOTE 3 – ACCOUNTS AND GRANTS RECEIVABLE

Accounts receivable consisted of the following as of June 30:

	<u>2003</u>	<u>2002</u>
Accounts receivable	\$ 4,523,521	\$ 5,417,389
Other receivables, including private grants and contracts	4,441,961	4,111,710
Gross accounts and grants receivable	8,965,482	9,529,099
Less allowance for uncollectable accounts	(1,761,563)	(1,271,018)
Net accounts and grants receivable	<u>\$ 7,203,919</u>	<u>\$ 8,258,081</u>

NOTE 4 – INVENTORIES

Inventories consisted of the following as of June 30:

	<u>2003</u>	<u>2002</u>
Bookstore	\$ 1,138,685	\$ 1,107,554
Food services	299,154	201,025
Facilities services	227,550	222,182
Livestock	672,610	681,694
Other	671,440	663,638
Total inventories	<u>\$ 3,009,439</u>	<u>\$ 2,876,093</u>

NOTE 5 – PREPAID EXPENSES

Prepaid expenses consisted of the following as of June 30:

	<u>2003</u>	<u>2002</u>
Leases	\$ 100,000	\$ 150,000
Library subscriptions	1,356,300	1,160,000
Other	1,140,790	875,318
Total prepaid expenses	<u>\$ 2,597,090</u>	<u>\$ 2,185,318</u>

NOTE 6 – LOANS RECEIVABLE

Student loans made under the Federal Perkins Loan Program constitute the majority of the University's loan balances. Included in non-current liabilities as of June 30, 2003 and 2002 are \$20,254,326 and \$19,812,258 that would be refundable to the Federal Government, should the University choose to cease participation in the Federal Perkins Loan program.

The Federal portion of interest income and loan program expenses are shown as additions to and deductions from the amount due to the Federal government, and not as operating transactions, in the accompanying financial statements.

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Notes to Consolidated Financial Statements
As of and for Each of the Two Years Ended June 30, 2003
(continued)

NOTE 7 – CAPITAL ASSETS

Following are the changes in capital assets for the years ended June 30, 2003 and 2002:

	Year Ended June 30, 2003				
	Balance July 1, 2002	Additions	Retirements	Transfers	Balance June 30, 2003
Capital assets not being depreciated:					
Land	\$ 4,212,403	\$ 63,600	\$ -	\$ -	\$ 4,276,003
Museum and fine art	4,306,153	-	-	-	4,306,153
Library special collections	3,460,950	-	-	-	3,460,950
Livestock for educational purposes	2,370,910	391,600	(10,800)	-	2,751,710
Construction work-in-progress	9,767,829	9,148,176	-	(13,030,200)	5,885,805
Total capital assets not being depreciated	24,118,245	9,603,376	(10,800)	(13,030,200)	20,680,621
Other capital assets:					
Furniture and equipment	\$ 74,991,262	8,713,667	(3,160,847)	(51,560)	80,492,522
Library materials	50,297,724	3,318,409	(794,602)	-	52,821,531
Buildings	165,794,851	254,400	(490,894)	503,431	166,061,788
Building improvements	103,604,687	2,823,148	-	11,151,721	117,579,556
Land improvements	11,834,000	840,205	-	741,401	13,415,606
Infrastructure	30,702,400	-	-	633,647	31,336,047
Total other capital assets	437,224,924	15,949,829	(4,446,343)	12,978,640	461,707,050
Accumulated depreciation	(233,365,958)	(18,244,283)	3,871,758	-	(247,738,483)
Other capital assets, net	203,858,966	(2,294,454)	(574,585)	12,978,640	213,968,567
Intangible assets, net	2,841,728	(774,024)	-	51,560	2,119,264
Capital Assets, net	230,818,939	\$ 6,534,898	\$ (585,385)	\$ -	\$ 236,768,452
Year Ended June 30, 2002					
	Balance July 1, 2001 (as restated)	Additions	Retirements	Transfers	Balance June 30, 2002
Capital assets not being depreciated:					
Land	\$ 4,212,403	\$ -	\$ -	\$ -	\$ 4,212,403
Museum and fine art	4,289,878	16,275	-	-	4,306,153
Library special collections	3,460,950	-	-	-	3,460,950
Livestock for educational purposes	2,370,910	-	-	-	2,370,910
Construction work-in-progress	3,394,572	9,042,197	-	(2,668,940)	9,767,829
Total capital assets not being depreciated	17,728,713	9,058,472	-	(2,668,940)	24,118,245
Other capital assets:					
Furniture and equipment	73,124,937	5,834,154	(3,967,829)	-	74,991,262
Library materials	48,215,265	2,800,818	(718,359)	-	50,297,724
Buildings	165,422,204	368,929	-	3,718	165,794,851
Building improvements	99,910,080	1,099,796	-	2,594,811	103,604,687
Land improvements	11,497,390	266,199	-	70,411	11,834,000
Infrastructure	30,702,400	-	-	-	30,702,400
Total other capital assets	428,872,276	10,369,896	(4,686,188)	2,668,940	437,224,924
Accumulated depreciation	(220,769,897)	(17,282,249)	4,686,188	-	(233,365,958)
Other capital assets, net	208,102,379	(6,912,353)	-	2,668,940	203,858,966
Intangible assets, net	3,337,077	(495,349)	-	-	2,841,728
Capital Assets, net	\$ 229,168,169	\$ 1,650,770	\$ -	\$ -	\$ 230,818,939

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Historical records are not available for certain of the University's assets. As such, some values have been estimated based on insurance values, industry-accepted valuation techniques, or estimates made by University personnel knowledgeable as to the assets' values. Livestock held for educational purposes consist primarily of cattle herds. Breeding cattle are routinely replaced in the herds with their offspring; additions and deductions from the asset cost are not reported for reproducing cattle replaced in this manner.

NOTE 8 – DEFERRED REVENUES

Deferred revenues consisted of the following as of June 30:

	2003	2002
Grant and contract funds received in advance	\$ 5,686,122	\$ 5,448,224
Summer session payments received in advance	3,042,233	2,756,754
Other deferred revenues	242,748	280,850
Total	<u>\$ 8,971,103</u>	<u>\$ 8,485,828</u>

NOTE 9 – ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities consisted of the following as of June 30:

	2003	2002
Compensation, benefits and related liabilities	\$ 15,559,375	\$ 13,170,408
Accrued interest expense	519,795	550,837
Accounts payable and other accrued liabilities	5,827,449	5,285,253
Total	<u>\$ 21,906,619</u>	<u>\$ 19,006,498</u>

NOTE 10 – NON-CURRENT LIABILITIES

Amounts not due within one year are reflected in the noncurrent liabilities section of the accompanying Statement of Net Assets, and as of June 30, 2003, include \$88,299,365 in bonds, notes and capital lease obligations and \$12,254,032 in compensated absence liabilities.

Following are the changes in non-current liabilities for the years ended June 30, 2003 and 2002:

	Year Ended June 30, 2003				
	Balance July 1, 2002	Additions	Reductions	Balance June 30, 2003	Amounts due within one year
Bonds and notes payable, and capital lease obligations					
Bonds payable, net of discount	\$ 92,856,065	\$ 482,230	\$ (4,180,000)	\$ 89,158,295	\$ 4,235,000
Notes and other debt	3,736,406	1,663,972	(1,242,289)	4,158,089	837,057
Capital lease obligations	140,490	113,982	(103,160)	151,312	96,275
Total bonds, notes and capital lease obligations	<u>\$ 96,732,961</u>	<u>\$ 2,260,184</u>	<u>\$ (5,525,449)</u>	<u>\$ 93,467,696</u>	<u>\$ 5,168,332</u>
Compensated absence liability	<u>\$ 21,673,555</u>	<u>\$ 11,304,457</u>	<u>\$ (10,081,855)</u>	<u>\$ 22,896,157</u>	<u>\$ 10,642,125</u>
Due to Federal government	<u>\$ 19,812,258</u>	<u>\$ 462,702</u>	<u>\$ (20,634)</u>	<u>\$ 20,254,326</u>	<u>\$ -</u>

Amounts not due within one year are reflected in the noncurrent liabilities section of the accompanying Statement of Net Assets, and as of June 30, 2002, include \$91,589,985 in bonds, notes and capital lease obligations, and \$11,798,722 in compensated absence liabilities.

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	Year Ended June 30, 2002				
	Balance, July 1, 2001	Additions	Reductions	Balance June 30, 2002	Amounts due within one year
Bonds and notes payable, and capital lease obligations					
Bonds payable, net of discount	\$ 96,387,544	\$ 458,521	\$ (3,990,000)	\$ 92,856,065	\$ 4,180,000
Notes and other debt	4,327,239	730,288	(1,321,121)	3,736,406	898,721
Capital lease obligations	237,413	220,836	(317,759)	140,490	64,255
Total bonds, notes and capital lease obligations	\$ 100,952,196	\$ 1,409,645	\$ (5,628,880)	\$ 96,732,961	\$ 5,142,976
Compensated absence liability	\$ 20,606,819	\$ 10,459,061	\$ (9,392,325)	\$ 21,673,555	\$ 9,874,833
Due to Federal government	\$ 19,381,963	\$ 466,078	\$ (35,783)	\$ 19,812,258	\$ -

Additional information regarding bonds, notes and capital leases is included in Notes 11 and 12.

NOTE 11 – REVENUE BONDS AND NOTES PAYABLE

Revenue bonds payable at June 30, 2003 were as follows:

Series 1993 A

Payable during the year ending June 30,	Interest Rate	Principal	Interest	Total
2004	4.450%	\$ 115,000	\$ 805,770	\$ 920,770
2005	4.600%	85,000	801,251	886,251
2006	4.700%	55,000	797,998	852,998
2007	4.750%	15,000	796,342	811,342
2008	5.000%	1,208,611	2,002,371	3,210,982
2009-2013	5.000 – 5.200 %	7,683,110	10,200,428	17,883,538
2014-2018	5.000 – 5.050 %	12,964,999	1,350,000	14,314,999
Total cash requirements		22,126,720	\$ 16,754,160	\$ 38,880,880
Bond discount amortized		3,771,575		
Balance, net of unamortized discount		\$ 25,898,295		

Series 1994 C

Payable during the year ending June 30,	Interest Rate	Principal	Interest	Total
2004	5.250%	\$ 130,000	\$ 112,230	\$ 242,230
2005	5.350%	135,000	105,207	240,207
2006	5.500%	140,000	97,745	237,745
2007	5.600%	150,000	89,695	239,695
2008	5.700%	160,000	80,935	240,935
2009-2013	5.700 – 6.000%	955,000	247,138	1,202,138
2014-2018	6.000%	325,000	15,750	340,750
Total cash requirements		\$ 1,995,000	\$ 748,700	\$ 2,743,700

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Series 1996 B

Payable during the year ending June 30,	Interest Rate	Principal	Interest	Total
2004	5.500%	\$ 2,055,000	\$ 480,464	\$ 2,535,464
2005	5.750%	2,205,000	360,615	2,565,615
2006	5.750%	2,370,000	229,123	2,599,123
2007	5.750%	2,555,000	87,573	2,642,573
2008	5.750%	235,000	6,812	241,812
Total cash requirements		<u>\$ 9,420,000</u>	<u>\$ 1,164,587</u>	<u>\$ 10,584,587</u>

Series 1996 D

Payable during the year ending June 30,	Interest Rate	Principal	Interest	Total
2004	4.600%	\$ 605,000	\$ 2,168,516	\$ 2,773,516
2005	4.750%	640,000	2,139,405	2,779,405
2006	4.750%	670,000	2,108,297	2,778,297
2007	4.875%	705,000	2,075,204	2,780,204
2008	5.000%	740,000	2,039,524	2,779,524
2009-2013	5.000 – 5.250 %	3,605,000	9,661,860	13,266,860
2014-2018	5.250 – 5.375 %	8,380,000	8,472,633	16,852,633
2019-2023	5.375%	22,535,000	3,492,726	26,027,726
2024-2027	5.625%	3,045,000	263,109	3,308,109
Total cash requirements		<u>\$ 40,925,000</u>	<u>\$ 32,421,274</u>	<u>\$ 73,346,274</u>

Series 1998 E

Payable during the year ending June 30,	Interest Rate	Principal	Interest	Total
2004	4.150%	\$ 255,000	\$ 354,617	\$ 609,617
2005	4.200%	265,000	343,763	608,763
2006	4.300%	280,000	332,182	612,182
2007	4.300%	290,000	319,929	609,929
2008	4.350%	305,000	307,063	612,063
2009-2013	4.400 – 4.800 %	1,735,000	1,313,331	3,048,331
2014-2018	4.850 – 5.000 %	2,210,000	839,652	3,049,652
2019-2023	5.000%	2,210,000	228,454	2,438,454
Total cash requirements		<u>\$ 7,550,000</u>	<u>\$ 4,038,991</u>	<u>\$ 11,588,991</u>

Series 1998 F

Payable during the year ending June 30,	Interest Rate	Principal	Interest	Total
2004	4.150%	\$ 1,075,000	\$ 119,985	\$ 1,194,985
2005	4.200%	1,125,000	74,062	1,199,062
2006	4.300%	1,170,000	25,291	1,195,291
Total cash requirements		<u>\$ 3,370,000</u>	<u>\$ 219,338</u>	<u>\$ 3,589,338</u>

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Total, all series

Payable during the year ending June 30,	Principal	Interest	Total
2004	\$ 4,235,000	\$ 4,041,582	\$ 8,276,582
2005	4,455,000	3,824,303	8,279,303
2006	4,685,000	3,590,636	8,275,636
2007	3,715,000	3,368,743	7,083,743
2008	2,648,611	4,436,705	7,085,316
2009-2013	13,978,110	21,422,757	35,400,867
2014-2018	23,879,999	10,678,035	34,558,034
2019-2023	24,745,000	3,721,180	28,466,180
2024-2027	3,045,000	263,109	3,308,109
Total cash requirements	85,386,720	\$ 55,347,050	\$ 140,733,770
Bond discount amortized	3,771,575		
Balance, net of unamortized discount	\$ 89,158,295		

Debt refunded, issued, and escrowed –

Issuance of Series A 1993 Bonds, November 9, 1993 Indenture – An original issue of \$24,911,720 dated November 9, 1993, consisting of \$3,055,000 of fully registered Current Interest Serial Bonds, plus \$6,036,720 of fully registered Capital Appreciation Bonds, and the remainder of fully registered Current Interest Term Bonds. A total of \$4.3 million was used to partially refund certain eligible portions of the Series B 1985 and Series A 1986 Indentures. The remainder of the proceeds was for the acquisition, construction, repair, remodeling, replacement, renovation, improvement, furnishing, and equipping of new and existing facilities at the University.

Issuance of the Series C 1994, June 16, 1994 Indenture – On June 16, 1994, the University issued Series C 1994 Revenue Bonds in the amount of \$12,250,000. \$10,517,921 of the proceeds were deposited into an irrevocable trust with an escrow agent to defease eligible portions of the Auxiliary Facilities and Student Building Fees Revenue Bonds Series A 1987, the Facilities Refunding Revenue Bond Series A 1988, and the Facilities Improvement Refunding Revenue Bonds Series B 1985. The remainder was used to fund capital projects.

Issuance of the Series B 1996, October 1, 1996 Indenture – On October 1, 1996, the University issued Series B 1996 Facilities Refunding Revenue Bonds in the amount of \$18,995,000. Proceeds from the sale of the bonds were used to: 1) advance refund \$18,440,000 of outstanding Series A 1986 bonds; 2) pay the bond insurance premium; and 3) pay certain costs associated with the issuance of the bonds. This transaction culminated a forward purchase agreement entered into in August 1993 with certain institutional investors.

Issuance of Series D 1996, August 15, 1996 Indenture – On August 15, 1996, the University issued Series D 1996 Facilities Improvement and Refunding Revenue Bonds in the amount of \$44,530,000, to be used for an advance refunding, construction and renovation of certain facilities, and to pay certain costs associated with the issuance of the bonds. Proceeds from the sale of the bonds were used to: 1) pay the costs of acquisition, construction, renovation, improvement, furnishing, and equipping certain facilities; 2) pay the bond insurance premium; and 3) pay certain costs associated with the issuance of the bonds. The bonds are fully insured by the Municipal Bond Insurance Association (MBIA).

The Series D 1996 bonds (and all subsequent bonds) are payable from and secured by a parity first lien on and pledge of certain gross and net revenues, which comprised: 1) all student building fees and

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certain student union use fees assessed against students attending the University; 2) net student housing system pledged revenues, after the payment of operation and maintenance expenses of such facilities; 3) certain rental and other income generated by the pledged facilities; 4) a HUD debt service grant; 5) lease rentals from the Museum of the Rockies; 6) all Land Grant income; 7) certain student athletic fees; 8) certain Health & Physical Education fees; 9) MSU- Bozeman Fieldhouse fees; and 10) capitalized interest and earnings on certain funds created under the Indenture.

Issuance of the Series E 1998, June 1, 1998 Indenture – On June 1, 1998, the University issued Series E 1998 Facilities Improvement Revenue Bonds in the amount of \$8,255,000. Proceeds from the sale of the bonds were used to: 1) finance the construction, improvement, repair, replacement, expansion, renovation, furnishing, and equipping of the Reno H. Sales Stadium at the Bozeman campus; 2) pay the premiums for the municipal bond insurance policy; and 3) pay certain costs associated with the issuance of the Series E 1998 bonds. Bonds maturing on or before November 15, 2008, are not subject to optional redemption prior to maturity. The MBIA unconditionally and irrevocably guarantees all bonds.

Issuance of the Series F 1998, June 1, 1998 Indenture – On June 1, 1998, the University issued Series F 1998 Facilities Improvement Revenue Bonds (Information Technology Project), in the amount of \$8,175,000. Proceeds were used for the purchase, installation and implementation of the Banner2000 software and required equipment, training and support. The bonds are unconditionally and irrevocably guaranteed by the MBIA, and are not subject to optional redemption prior to maturity.

Defeased bonds – In prior years, the University defeased certain bond issues by placing proceeds of new bonds in an irrevocable trust. The proceeds, together with interest earned thereon, will be sufficient for future debt service payments on the refunded issues. Accordingly, neither the trust account assets nor the liability for the defeased bonds are included in the University's financial statements. Certain of the transactions met the qualifications for legal defeasance, while others are considered to be defeased in substance. At June 30, 2003 and 2002, \$5,640,000 and \$7,449,000 of bond principal outstanding was considered to be defeased in substance.

On October 15, 2003, the University issued \$18,760,000 in Municipal Auction Rate Securities as Series 2003 G Revenue Bonds. Of this total, \$16,745,000 was used for a current refunding of the Series 1993-A bonds and \$2,015,000 was used for an advance refunding of the Series 1994 C bonds. The new bonds are ten year variable rate bonds, priced on a 35-day rate period. They are unconditionally and irrevocably guaranteed by XL Capital Assurance. The bonds were issued in denominations of \$25,000, with principal repayments scheduled each May 15 and November 15 through November, 2016. Bond proceeds, along with monies from the University, were sufficient to legally defease that portion of the Series 1993 A bonds that were called, and the Series 1994 C bonds that will be called on November 15, 2004.

Notes payable – The University participates in the State's InterCap loan program, and may also enter into indebtedness with commercial and other private lenders. InterCap loans contain a variable interest rate, which is based on the underlying bond rate of the Montana Board of Investments InterCap bonds, and is adjusted annually.

Scheduled maturities of notes payable are as follows:

Payable during the year ending June 30,	Principal	Interest	Total
2004	\$ 837,058	\$ 112,938	\$ 949,996
2005	831,053	102,775	933,828
2006	638,850	80,004	718,854
2007	426,272	64,733	491,005
2008	408,378	38,391	446,769
2009-2013	1,016,478	73,826	1,090,304
Total	\$ 4,158,089	\$ 472,667	\$ 4,630,756

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Notes payable consisted of the following as of June 30:

Description	Interest Rate	Maturity Date	2003 Balance	2002 Balance
<i>InterCap:</i>				
Agriculture Bioscience Building	2.85%	08/15/09	\$ 433,711	\$ 493,735
Information Technology Center Software	-	-	-	20,477
Information Technology Center Telephone Upgrade	2.85%	02/15/07	140,976	172,626
Student Weight Room	2.85%	02/15/11	321,867	354,185
Athletics Stadium Sign, Scoreboard and Sound System	-	-	-	305,121
Information Technology Center Servers	2.85%	02/15/04	16,809	32,785
Athletics Department Laundry Equipment	2.85%	02/15/04	4,217	8,209
Arts & Architecture	2.85%	02/15/07	134,401	71,472
Software and Software Licenses	2.85%	02/15/06	228,650	296,842
Land Resources & Environmental Sciences Post Equipment	2.85%	08/15/05	14,816	20,272
University Printing Equipment	2.85%	02/15/05	20,018	29,345
KUSM Vehicle	2.85%	02/15/06	15,813	20,847
SHS Blood Analyzer	2.85%	02/15/07	23,458	28,700
College of Technology Process Technology	2.85%	08/15/08	156,203	180,443
Special Education Building	-	-	-	41,575
Renovate Gymnasium & Swimming Pool	2.85%	08/15/03	39,433	115,622
Science Lab Renovation	2.85%	02/15/06	107,761	144,580
Energy Conservation	2.85%	08/15/08	223,309	266,005
Parking Lot/Road Improvements	2.85%	08/15/07	76,375	93,111
Electrical Loop	2.85%	08/15/10	144,200	159,449
Great Falls College of Technology Computers	-	-	-	26,062
Point of Sale System-Bookstore	2.85%	08/15/08	53,176	-
Athletics Video Equipment	2.85%	02/15/07	102,725	-
HRDC Copier	2.85%	02/15/07	2,795	-
ITC Building Wiring	2.85%	02/15/10	500,000	-
KUSM TV Satellite	2.85%	02/15/05	225,000	-
Network - Telephone Alumni	2.85%	08/15/08	26,100	-
<i>Subtotal, InterCap Loan Principal</i>			<u>3,011,813</u>	<u>2,881,463</u>
<i>GE Capital:</i>				
Library Computing Equipment	5.78%	01/01/04	7,269	16,487
Architecture	5.50%	03/01/04	1,599	3,631
Great Falls Library 1	5.90%	04/01/04	2,778	5,399
Great Falls Library 2	4.99%	09/01/04	2,405	4,225
Bozeman Library	4.99%	09/01/04	15,828	27,802
<i>Subtotal, GE Capital Loan Principal</i>			<u>29,879</u>	<u>57,544</u>
<i>Key Municipal Finance-</i>				
Renne Library	4.10%	02/01/05	176,057	258,867
<i>Lease Innovations-</i>				
Athletic Video Equipment	-	-	-	115,832
<i>Norwest Bank-</i>				
Renne Library	-	-	-	33,164
Athletic Equipment	-	-	-	5,642
<i>Subtotal, Norwest Bank Loan Principal</i>			<u>-</u>	<u>38,806</u>
<i>Accutitle Incorporated-</i>				
3009 Yucca Escrow Agreement	7.75%	10/27/04	28,701	49,073
<i>Cisco:</i>				
Information Technology Services Equipment	5.75%	12/20/05	72,493	104,103
Information Technology Services Cable	5.75%	06/20/06	137,128	182,171
<i>Subtotal, Cisco Loan Principal</i>			<u>209,621</u>	<u>286,274</u>
<i>MSU-Northern Foundation:</i>				
Athletics Wrestling Van	6.50%	10/01/04	4,543	6,609
Voice Mail System	-	-	-	17,899
MacKenzie Hall Wiring	5.00%	10/01/11	124,263	-
Campus Backbone Wiring	5.00%	10/01/11	201,624	-
Digital Phone System	5.00%	10/01/11	133,901	-
Brockman Wiring	5.00%	10/01/11	46,062	-
ITS Electronics	5.00%	10/01/11	174,319	-
Student Services Office Equipment and Carpeting	6.50%	10/01/04	10,258	14,922
Athletics Volleyball Van	6.50%	10/01/05	7,048	9,117
<i>Subtotal, MSU-Northern Foundation Loan Principal</i>			<u>702,018</u>	<u>48,547</u>
Total note principal outstanding			<u>\$ 4,158,089</u>	<u>\$3,736,406</u>

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NOTE 12 - CAPITAL LEASE OBLIGATIONS

Capital Leases: The University has future minimum lease commitments for capital lease obligations consisting of the following at June 30, 2003:

Payable during the year ending June 30,	Principal and Interest
2004	\$ 112,438
2005	29,189
2006	21,256
2007	9,625
Total payments	172,508
Less amount representing interest	(21,196)
Principal balance outstanding	<u>\$ 151,312</u>

NOTE 13 - UNRESTRICTED NET ASSETS

As of June 30, the University's unrestricted net assets consisted of the following:

	2003	2002
General operating funds	\$ (14,460,012)	\$ (13,399,109)
Facility renewal and replacement funds	15,821,325	14,576,002
Student services and auxiliary department reserves, including inventories	10,672,366	12,359,591
Indirect cost recoveries and research-related funds	11,472,762	10,409,048
Instruction, academic support and public service department funds	7,315,006	6,766,703
Unexpended plant funds	3,459,516	3,769,027
Retirement of indebtedness funds	3,050,449	2,163,639
Facilities services balances, including inventories	2,267,021	2,312,213
Employer-provided benefits reserves	1,181,719	1,668,422
Agricultural Experiment Station and Extension Services funds	1,521,055	1,456,978
Administration and finance department funds	2,348,894	1,333,162
Student organization funds	930,945	1,031,945
Livestock inventories	672,610	681,694
President's office funds	660,545	184,273
Other funds	88,318	169,008
Total unrestricted net assets	<u>\$ 47,002,519</u>	<u>\$ 45,482,596</u>

The University has not funded the compensated absences balance related to employees paid using unrestricted funds, creating negative net asset balances of \$14.5 and \$13.4 million as of June 30, 2003 and 2002, respectively. Other funds have largely been earmarked for minor and major equipment replacement, facility renovation, operating contingencies, and maintenance and renovation projects in progress as of June 30.

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NOTE 14 – MATRIX OF NATURAL AND FUNCTIONAL OPERATING EXPENSES

The University's operating expenses consisted of the following during the year ended June 30, 2003:

Type and classification of operating expense:	Instruction	Research	Public Service	Academic support	Student services	Institutional Support	Plant-related expenses	Auxiliary Enterprises	Other classifications	Total
Compensation	\$ 56,021,935	\$ 38,768,728	\$ 13,812,963	\$ 10,692,509	\$ 10,608,285	\$ 9,107,202	\$ 5,404,721	\$ 11,553,462	\$ -	\$ 155,969,805
Benefits	14,312,848	8,754,481	3,695,743	2,608,879	2,579,955	2,622,645	1,795,922	2,884,848	-	39,255,321
Contracted services	2,953,535	13,381,156	3,981,305	1,006,014	2,075,101	2,119,159	2,310,646	1,432,907	-	29,259,823
Supplies	2,703,847	7,548,543	1,228,430	1,102,873	1,493,963	327,083	2,054,264	3,973,988	-	20,432,991
Communications	1,088,129	565,443	497,552	265,390	943,065	571,897	130,307	511,219	-	4,573,002
Travel	1,222,374	3,220,829	1,195,769	721,200	1,862,409	258,549	9,039	130,811	-	8,420,980
Utilities	12,752	272,590	16,744	28,376	59,048	390	4,182,225	2,040,722	-	6,612,847
Cost of sales	47,704	138,966	28,761	657,555	17,124	15,544	47,029	4,491,937	-	5,444,620
Maintenance	289,364	879,353	124,091	280,502	152,567	148,623	3,502,488	2,007,981	-	7,384,969
Other expenses	930,899	1,126,236	2,437,230	825,840	1,024,310	1,943,399	68,275	610,305	-	8,966,494
Rent	121,837	389,807	336,809	67,842	156,854	169,796	721,218	317,449	-	2,281,612
Scholarships and fellowships	-	-	-	-	-	-	-	-	15,501,298	15,501,298
Depreciation and amortization	-	-	-	-	-	-	-	-	19,627,347	19,627,347
Total	\$ 79,705,224	\$ 75,046,132	\$ 27,355,397	\$ 18,256,980	\$ 20,772,681	\$ 17,284,287	\$ 20,226,134	\$ 29,955,629	\$ 35,128,645	\$ 323,731,109

Montana State University
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Notes to Consolidated Financial Statements
As of and for Each of the Two Years Ended June 30, 2003

(continued)

The University's operating expenses consisted of the following during the year ended June 30, 2002:

Type and classification of operating expense:	Instruction	Research	Public Service	Academic support	Student services	Institutional support	Plant-related expenses	Auxiliary enterprises	Other classifications	Total
Compensation	\$ 51,502,720	\$ 34,543,450	\$ 13,917,665	\$ 11,046,819	\$ 9,552,629	\$ 7,322,437	\$ 4,971,952	\$ 10,900,559	\$ -	\$ 143,756,231
Benefits	13,085,001	7,551,858	3,902,014	2,864,662	2,477,831	2,596,978	1,670,769	2,506,817	-	36,675,930
Contracted services	2,264,573	8,664,291	3,116,471	960,125	1,660,815	2,316,323	2,579,656	1,871,989	-	23,434,243
Supplies	2,569,768	7,089,936	1,382,019	1,160,381	1,311,151	399,152	3,287,315	3,947,862	-	21,147,584
Communications	878,002	491,314	521,188	371,911	806,025	553,862	140,871	484,713	-	4,247,886
Travel	1,432,486	2,524,049	1,172,993	264,558	1,495,380	184,709	55,512	92,967	-	7,222,664
Utilities	9,160	210,300	18,063	4,816	78,914	161	4,426,391	1,953,488	-	6,701,293
Cost of sales	63,288	148,264	54,189	32,545	99,877	-	32,328	4,242,768	-	4,673,259
Maintenance	366,391	1,189,384	150,959	236,986	114,248	103,963	3,853,204	2,096,321	-	8,111,456
Other expenses	926,605	555,033	1,927,630	852,017	910,961	1,354,597	581,875	262,715	-	7,371,433
Rent	101,598	298,422	144,512	99,796	144,642	136,559	513,117	331,137	-	1,769,783
Scholarships and fellowships	-	-	-	-	-	-	-	-	14,674,569	14,674,569
Depreciation and amortization	-	-	-	-	-	-	-	-	18,247,814	18,247,814
Total	\$ 73,199,592	\$ 63,266,301	\$ 26,307,703	\$ 17,914,616	\$ 18,652,483	\$ 14,968,741	\$ 22,112,950	\$ 28,691,336	\$ 32,922,383	\$ 298,036,145

Montana State University
(a component unit of the State of Montana)
Notes to Consolidated Financial Statements
As of and for Each of the Two Years Ended June 30, 2003
(continued)

NOTE 15 – RETIREMENT PLANS

University employees eligible to participate in retirement programs are members of either the Public Employees' Retirement System (PERS), the Game Wardens and Peace Officers Retirement System (GWPORS), Teacher's Retirement System (TRS) the Optional Retirement Program (ORP), Federal Employees' Retirement System (FERS) or the U.S. Civil Service Retirement System (CSRS). ORP commenced in January 1988, and is underwritten by the Teachers' Insurance and Annuity Association-College Retirement Equities Fund (TIAA-CREF). Effective July 1, 1993, ORP was made the mandatory retirement plan for new faculty and administrative staff. The Pension Benefit Obligation is not available on an individual agency basis, but is available on a statewide basis from the Montana Retirement systems or TIAA-CREF.

ORP - The ORP is a defined contribution plan, established under authority of Title 19, Chapter 21, MCA. Benefits at retirement depend upon the amount of investment gains and losses and the employee's life expectancy at retirement. Under the ORP, each employee enters into an individual contract with TIAA-CREF. The University records employee/employer contributions, and remits monies to TIAA-CREF. Individuals are immediately vested with contributions. Annual reports that include financial statements and required supplemental information on the plan are available from TIAA-CREF, 730 Third Avenue, New York, New York 10017-3206, Phone 1-800-842-2733.

TRS - This system was established in 1937 and is governed by Title 19, Chapter 4, MCA, as a cost-sharing multi-employer defined benefit pension plan providing retirement services to all persons employed as teachers or professional staff of any public elementary or secondary school, vocational-technical center or unit of the University System. Eligibility is met with a minimum of 25 years of service or age 60 with 5 years of creditable service. The formula for benefits is 1/60 times creditable service years times average final compensation. Rights are vested after 5 years of creditable service, and vested employees may retire at or after age 50 and receive reduced retirement benefits. Additional information or a separate financial statement can be obtained from the State of Montana, Department of Administration, Teachers' Retirement Division, P.O. Box 200139, Helena, MT 59620-0139.

PERS - This system was established in 1945 and is governed by Title 19, Chapter 3, MCA, as a cost-sharing multi-employer defined benefit pension plan providing retirement services to substantially all public employees. Effective July 1, 2002, eligible new employees of the University are defaulted into the PERS defined benefit plan and have one year from their date of hire to elect whether to stay in the PERS defined benefit plan, enroll in the ORP plan, or enroll in the PERS Defined Contribution Plan. Benefit eligibility is age 60 with at least 5 years of service, age 65 regardless of service, or 30 years of service regardless of age. Actuarially reduced benefits may be taken with 25 years of service or at age 50 with at least 5 years of service. Monthly retirement benefits are determined by multiplying 1/56 by the number of years of service by the final average salary, unless the employee has 25 years of service in which case the multiplier is 1/50. Members' rights become vested after 5 years of service. Additional information or a separate financial statement can be obtained from the State of Montana, Department of Administration, Public Employees' Retirement Administration, P.O. Box 200131, Helena, MT 59620-0131.

GWPORS - This retirement system was established in 1963 and is governed by Title 19, Chapter 8, MCA, to provide retirement services for all persons employed as game wardens and peace officers. Effective July 1, 1997, this system became the mandatory system for campus security officers employed by the Montana University System, unless they already held membership in another State retirement system. Participants are eligible to retire after completing 20 years of service and reaching age 50. Early retirement with a reduced benefit may be taken after completing 5 years of service and reaching 55 years of age. The retirement formula is 2% of the final average salary per year of service. Members' rights become vested after 5 years of service. Additional information or a separate financial statement can be obtained from the State of Montana, Department of Administration, Public Employees' Retirement Administration, P.O. Box 200131, Helena, MT 59620-0131.

Montana State University
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Notes to Consolidated Financial Statements
As of and for Each of the Two Years Ended June 30, 2003
(continued)

FERS - This plan commenced in 1986 and is available to Federal employees joining the Extension Service staff without a break in service. This retirement plan contains defined benefit plan components, a Basic Benefit Plan and Social Security, and a defined contribution component, the Thrift Savings Plan (TSP). Basic benefits can be received at age 55 with as little as 10 years of service, and minimum retirement benefits at age 62 with 5 years of service. The formula for basic benefits is 1% of the highest consecutive three-year-average salary multiplied by the number of years of service. At age 62, retirees are eligible for cost of living adjustments on retirement benefits. The TSP benefits at retirement depend upon the amount of employer contributions, employee voluntary contributions and investment gains and losses.

CSRS - This retirement plan is authorized under the Smith-Lever Act of 1914 as amended and is available to Federal employees joining the Extension Service staff without a break in service. CSRS is a defined benefit plan. The retirement benefits are based upon the highest consecutive three-year-average salary. Retirees are eligible for cost of living adjustments the year after retirement. Benefits can be received at age 55 with 30 years of service, age 60 with 20 years of service, or age 62 with five years of service.

Pension data for the year ended June 30, 2003 was as follows:

	PERS	TRS	ORP	CSRS	FERS	GWPORS
Covered payroll	\$ 41,029,441	\$ 25,427,911	\$ 69,256,713	\$ 2,175,692	\$ 729,009	\$ 301,688
Total Payroll	\$158,541,604	\$158,541,604	\$ 158,541,604	\$ 158,541,604	\$158,541,604	\$ 158,541,604
Employer contributions	\$ 2,831,032	\$ 2,573,985	\$ 3,423,176	\$ 169,273	\$ 82,802	\$ 27,152
% of covered payroll	6.900%	7.470%	4.490%-4.956%	7.77%-7.94%	11.360%	9.000%
Employee contributions	\$ 2,831,032	\$ 1,818,093	\$ 4,875,604	\$ 207,794	\$ 64,959	\$ 31,858
% of covered payroll	6.900%	7.150%	6.9% - 7.044%	0.8% - 6.93%	0.800%	10.560%
ORP contribution to other plans	\$ 47,508	\$ 2,718,925	-	-	-	-
% of ORP contribution	2.41%	4.040%	-	-	-	-

Covered payroll excludes students employed under the College Work Study programs and part-time student employees.

Amounts contributed to retirement plans during the past three years were equal to the required contribution each year. The amounts contributed by the University and its employees were:

Year ended June 30,	PERS	TRS	ORP	CSRS	FERS	GWPORS
2001	\$ 5,164,950	\$ 6,010,806	\$ 6,435,645	\$ 311,847	\$ 89,306	\$ 43,578
2002	\$ 5,526,092	\$ 6,528,302	\$ 7,097,452	\$ 299,771	\$ 86,104	\$ 44,700
2003	\$ 5,709,572	\$ 7,111,003	\$ 8,298,780	\$ 377,067	\$ 147,761	\$ 59,010

Montana State University
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Notes to Consolidated Financial Statements
As of and for Each of the Two Years Ended June 30, 2003
(continued)

Pension data for the year ended June 30, 2002 was as follows:

	PERS	TRS	ORP	CSRS	FERS	GWPORS
Covered payroll	\$ 40,044,137	\$ 28,309,341	\$ 59,145,441	\$ 3,061,446	\$ 716,198	\$ 234,417
Total Payroll	\$ 149,379,366	\$ 149,379,366	\$ 149,379,366	\$ 149,379,366	\$ 149,379,366	\$ 149,379,366
Employer contributions	\$ 2,763,046	\$ 2,114,707	\$ 2,931,248	\$ 167,564	\$ 80,593	\$ 21,098
% of covered payroll	6.900%	7.470%	4.956%	5.470%	11.250%	9.000%
Employee contributions	\$ 2,763,046	\$ 2,024,119	\$ 4,166,204	\$ 132,207	\$ 5,511	\$ 23,602
% of covered payroll	6.900%	7.150%	7.044%	4.320%	0.770%	10.560%
ORP contribution to TRS	-	\$ 2,389,476	-	-	-	-
% of ORP contribution to TRS	-	4.040%	-	-	-	-

NOTE 16 – RISK MANAGEMENT

Due to the diverse risk exposure of the University and its constituent agencies, the insurance portfolio contains a comprehensive variety of coverage. Montana statutes, 2-9-101 through 305, MCA and ARM 2-2-298, require participation of all state agencies in the self insurance plan established by the Montana Department of Administration, Risk Management and Tort Defense Division (RMTDD). The self insurance program includes coverage for commercial general liability, auto liability, professional liability, and errors and omissions exposures. The RMTDD provides coverage, above self insured retentions, by purchasing other commercial coverage through the State's broker, Willis of Seattle, for excess liability, property, crime, fidelity, boiler and machinery, fine arts, aircraft-liability and hull coverage. The RMTDD also supplies other commercial insurance coverage for specific risk exposures on an as needed basis such as the Volunteer Accident and Health, Dismemberment and Accidental Death coverage obtained for all units of the Montana University System. In addition to these basic policies, the University's Department of Safety and Risk Management ("SRM") establishes guidelines and provides consultation in risk assessment, risk avoidance, risk acceptance and risk transfer.

The Tort Claims Act of the State of Montana, 2-9-102 MCA, "provides that Governmental entities are liable for its torts and of those of its employees acting within the course and scope of their employment or duties whether arising out of a governmental or proprietary function, except as specifically provided by the Legislature". Accordingly, 2-9-305 MCA requires that the State "provide for the immunization, defense and indemnification of its public officers and employees civilly sued for their actions taken within the course and scope of their employment". Safety and Risk Management also provides commercial coverage for other risk exposures that are not covered by the State's self insurance program.

Buildings and contents – are insured for replacement value. For each loss covered by the State's self insurance program and commercial coverage, MSU has a \$1,000 per occurrence retention.

General liability and tort claim coverage – include comprehensive general liability, auto liability, personal injury liability, officer's and director's liability, professional liability, aircraft liability, watercraft liability, leased vehicles and equipment liability, and are provided for by the University's participation in the State's self insurance program.

Self-Funded Programs – The University's health care program is self-funded, and is provided through participation in the Montana University System (MUS) Inter-unit Benefits Program. The MUS program is funded on an actuarial basis and the University believes that sufficient reserves exist to pay run-off claims related to prior years, and that premiums and University contributions are sufficient to pay current and future claims.

Montana State University
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Notes to Consolidated Financial Statements
As of and for Each of the Two Years Ended June 30, 2003
(continued)

The MUS program incorporates a self insured retention of \$500,000 per claim and excess commercial coverage to statutory limits. Employer's liability is provided with a \$500,000 retention and an excess insurance limit of \$1,000,000. The University provides periodic disbursements to the administrator for claims paid and administrative expenses.

NOTE 17 – COMMITMENTS AND CONTINGENT LIABILITIES

Operating leases – The University has commitments under non-cancelable operating leases as follows:

Minimum rental payments for operating leases are due in the years ending June 30,	Amount
2004	\$ 479,281
2005	435,263
2006	382,732
2007	167,689
2008	20,369
Total	<u>\$ 1,485,334</u>

Payments made under noncancelable operating leases during the years ended June 2003 and 2002 totaled \$467,191 and \$459,943, respectively.

Legal actions – The University is a defendant in legal actions arising in the normal course of business. While the outcome cannot be determined at this time, management is of the opinion that the liability, if any, from these actions will not have a material effect on the University's financial position, results of operations or cash flows.

Refundable grants – The University receives grants and other forms of reimbursement from various Federal and State agencies. These funds are subject to review and audit by cognizant agencies. The University does not expect any material adjustments or repayments to result from such audits.

Montana State University
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Notes to Consolidated Financial Statements
As of and for Each of the Two Years Ended June 30, 2003
(continued)

As of June 30, 2003, the University had initiated construction on the following major capital and maintenance projects:

Description	Amount Expended through June 2003	Remaining Amount Authorized	Total Expected Project Cost
Heat Plant Seismic	\$ 25,254	\$ 152,153	\$ 177,407
Steam & Condensate Extension	117,785	102,831	220,616
Roberts Hall Roof	24,162	825,838	850,000
Romney Gutter Repairs	183,359	14,641	198,000
Gaines Hall Design	1,201,787	798,213	2,000,000
Replace Linfield South Roof	140,673	90,327	231,000
Renovate Exterior Linfield & Montana Hall	1,290,940	159,060	1,450,000
Animal Bioscience Facility	68,635	4,931,365	5,000,000
SARC Renovation	380	1,249,620	1,250,000
EARC Renovation	39,727	170,273	210,000
NARC Renovation	-	200,000	200,000
CARC Renovation	164,326	15,674	180,000
NWARC Renovation	-	160,000	160,000
Leon Johnson Lecture Reroof	-	235,637	235,637
MSU Farm Overhead Electrical Relocation	70,881	77,369	148,250
Montana Hall Seismic Repairs	19,851	25,149	45,000
Herrick Comprehensive Study	126,084	23,916	150,000
MSU ADA Compliance Projects	-	48,428	48,428
Traphagen Eaves Repair	143	76,363	76,506
Miller Dining Pizza Oven	32,934	40,566	73,500
Hedges Re-roof	18,526	356,474	375,000
Hapner FatCat Bakery	133,207	89,793	223,000
MSU- Bozeman Stadium Skyboxes	113,808	1,192	115,000
MSU- Bozeman Skybox II	5,118	169,882	175,000
Hamilton Hall Parking Lot Renovation	62,276	162,724	225,000
Fieldhouse Roof Replacement	140,128	1,659,872	1,800,000
Cooley B-1,2,3	15,889	124,111	140,000
Cooley B-2	15,262	7,238	22,500
Student Lab Improvement	106,515	182,051	288,566
COT Tech Training Center	183,136	1,085,532	1,268,668
A.S. & Science Building Roofs	-	208,000	208,000
Canal Bridge	12,750	357,750	370,500
2712 Normal Remodel	93,056	50,944	144,000
Petro Hall Air Handler	-	115,000	115,000
Peaks to Plains Rims	22,362	127,638	150,000
Downtown Remodel	33,938	1,062	35,000
Residence Hall Wiring	48,184	201,816	250,000
Davey Pioneer	42,029	21	42,050
Steam Boiler Project	26,300	3,700	30,000
Applied Technology Center Construction	406,512	3,593,488	4,000,000
Cowan Hall Windows	543,879	21,411	565,290
Cowan Hall Heating and Air Conditioning	929,088	1,418,912	2,348,000
Totals	\$ 6,458,884	\$19,336,034	\$ 25,794,918

NOTE 18 – RELATED PARTIES

The University is a component unit of the State of Montana. The accompanying financial statements include only the activities, funds and accounts of the University. Private nonprofit organizations with relations to the University include MSU-Bozeman Foundation, MSU-Billings Foundation (including the Sting Athletic Association and the Alumni Association), MSU-Northern Foundation, MSU-Bozeman Alumni Association, MSU-Bozeman Athletic Scholarship Association, MSU-Bozeman Bookstore, MSU-Bozeman Friends of KUSM, MSU-Billings Friends of KEMC, Museum of the Rockies, Inc., and The Research and Development Institute, Inc. (dissolved October, 2002).

Montana State University
(a component unit of the State of Montana)
Notes to Consolidated Financial Statements
As of and for Each of the Two Years Ended June 30, 2003
(continued)

The foundations and associations operate exclusively for the purposes of encouraging, promoting and supporting educational programs, research, scholarly pursuits and athletics at, or in connection with, the University.

During the years ended June 30, 2003 and 2002, respectively, the Foundations provided to the University \$6,552,129 and \$5,034,445 in scholarship and other gift support. The University provided to its Foundations \$1,311,366 and \$954,546, during the years ended 2003 and 2002, respectively, which included payments for contracted services, capital campaign support, and operating leases. In addition, renovations of leased space valued at \$66,866 and \$680,783 were completed during 2003 and 2002, respectively.

Friends of Montana Public Television provided \$415,333 during 2003 and \$408,256 during 2002, and Friends of KEMC Public Radio provided \$310,000 during 2003 and \$395,445 during 2002 in support of the University's television and radio stations.

The Museum of the Rockies, Incorporated, paid \$300,000 per year to the University for facility rental, and provided \$1,186,305 and \$1,298,687 during 2003 and 2002, respectively, in support of the University, primarily as reimbursement for Museum staff salaries and benefits.

The MSU- Bozeman Athletic Scholarship Association provided \$439,980 and \$371,000 in support of athletic programs.

The University foundations are independent corporations formed for the purpose of fundraising and receiving funds for the sole benefit of the University. The majority of the assets held by the foundations are restricted by donors for specific purposes, and are not recorded in the accompanying financial statements until they are received by the University in the form of gifts.

NOTE 19 – SUBSEQUENT EVENTS

Effective July 1, 2003, the University adopted a self-funded workers' compensation insurance program, provided through membership in the MUS Self Insured Worker's Compensation Program. The MUS program is funded on an actuarial basis and is administered by a third party, Missoula County. Benefits provided are prescribed by state law and include biweekly payments for temporary loss of wages as well as qualifying permanent partial and permanent total disability. Medical and indemnity benefits are statutorily prescribed for qualifying job-related injuries or illnesses.

In August 2003, Moody's Investors Services upgraded its rating of Montana State University bonds to A2 from an A3, citing an increased student demand, solid financial management and a bright outlook. The upgrade came as Moody's reviewed MSU facility bonds that were refunded in October, 2003, as discussed in Note 11.

In November, 2003, the Board of Regents approved a 50% tuition waiver for dependents of MUS employees who meet certain length-of-service and other criteria. Approval was granted on a one-year trial basis, beginning with the summer, 2003 semester. Management has not yet determined the effect this will have on the University's financial position, results of operations or cash flows.



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LEGISLATIVE AUDIT DIV.

Office of the President

211 Montana Hall
P.O. Box 172420
Bozeman, MT 59717-2420

Telephone (406) 994-2341
Fax (406) 994-1893

December 4, 2003

Mr. Scott A. Seacat
Legislative Auditor
Legislative Audit Division
State Capitol, Room 135
P.O. Box 201705
Helena, MT 59620-1705

Dear Mr. Seacat:

Montana State University would like to thank the Legislative Audit Division for their time in auditing the financial statements for the fiscal year ended June 30, 2003. We feel this audit was productive and instrumental in continually improving the financial reporting of all Montana State University campuses. We look forward to working with you again next year.

Sincerely,

A handwritten signature in black ink, appearing to read "G. Gamble".

Geoffrey Gamble
President

Enclosure